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BUDGET ANALYSIS 1997 BIENNIUM

OVERVIEW

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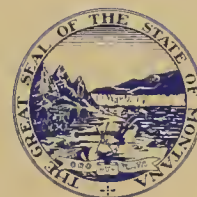
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BUDGET ANALYSIS

1997 Biennium

Overview

Presented to the Fifty-fourth Legislature

Submitted by

The Office of the Legislative Fiscal Analyst

Helena, Montana

January 1995

Legislative Fiscal Analyst
CLAYTON SCHENCK



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STATE OF MONTANA
Office of the Legislative Fiscal Analyst

December 1994

Members of the Fifty-Fourth Legislature
Members of the Legislative Finance Committee

In accordance with Section 5-12-302, MCA, I submit for your consideration a fiscal analysis of the state budget outlook for the 1997 biennium and Governor Racicot's Executive Budget. This includes the "Overview" report that presents a broad fiscal overview and discusses significant fiscal issues. In addition, Volumes I and II provide a more detailed analysis of the components of the Executive Budget, and are designed to be a working document during the appropriations process.

The staff of the Office of the Legislative Fiscal Analyst look forward to being of service to the legislature during the 1995 session. We are here to assist all legislators in obtaining the best possible fiscal information to facilitate setting fiscal policy and appropriations.

We thank the Office of Budget and Program Planning and agency staff for the most open and cooperative budget development effort in recent memory.

I am deeply indebted to the LFA staff for the thousands of extra hours and their personal sacrifice in preparing this analysis. The dedication and hard work of the staff are a credit to the legislature and the people of Montana.

Respectfully submitted,

A handwritten signature in cursive script that reads "Clayton Schenck".

Clayton Schenck
Legislative Fiscal Analyst



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CONTENTS

Staff Assignments	iv
Introduction	Overview 1
Budget Overview	
State Fiscal Outlook	5
Executive Budget Analysis - Summary	17
Revenue Proposals	24
Expenditure Proposals	25
Fund Balance	39
Fiscal 1995 Supplementals	41
Executive Pay Plan	43
School Equalization Account	51
Structural Imbalance	61
Guaranteed Annual Benefit Adjustment Proposal	63
Inflation/Deflation Factor Issues	65
Other Fiscal Issues	
SB 378 - Dedicated Revenue Provisions	67
Retirement Incentive Program	71
Performance-Based Budgeting	72
Task Force to Renew Montana Government	73
Health Care Authority	74
Tax Policy & Initiatives	
	Tax Policy
Summary	1
Income Tax Refund	3
Permanent Coal Tax Trust Proposals	4
Oil & Gas Taxation Reform (Project 95)	6
Coal Severance Tax Reallocation	16
Revenue	
	Revenue
Introduction	1
Economic Overview	2
Major Economic Assumptions	13
General Fund Revenue Estimates	16
SEA Revenue Estimates	53
Trust Funds - Balances & Interest Earnings	71
Resource Indemnity Trust Interest Accounts	76
Agency Budget Analysis	
General Government and Transportation	Agency-1
Human Services	Section A
Natural Resources and Commerce	Section B
Institutions and Public Safety	Section C
Education	Section D
Long-Range Planning	Section E
Reference	
	Reference
Budget Basics	1
Agency Budget Comparisons By Fund	12
Expenditure Limitation	19
Statutory Appropriations	22

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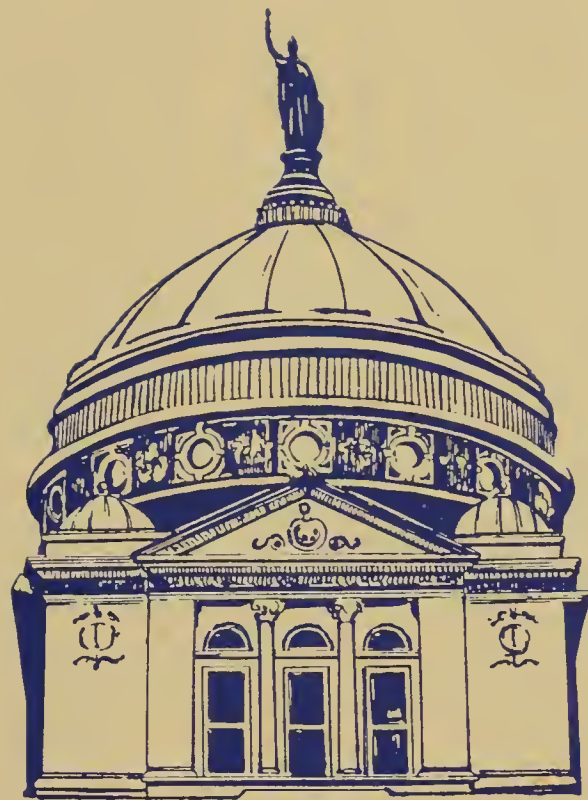
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INTRODUCTION

INTRODUCTION

Purpose of Report

The purpose of this report is to assist the 1995 Legislature in setting its fiscal priorities and reflecting those priorities in the 1997 Biennium General Appropriations Act and in other fiscal legislation. It seeks to accomplish this by: 1) providing an outlook of the state's fiscal condition; 2) analyzing the budget proposed by the Governor for the 1997 biennium; and 3) identifying some of the major fiscal issues facing the Fifty-fourth legislature. This overview is intended to complement Volumes I and II of the LFA 1997 Biennium Budget Analysis, which contain an in-depth review of the Governor's Budget.

Volumes I and II report the economic assumptions and revenue forecast as well as the detailed examination of state agency programs. In contrast, this document presents a broader fiscal overview and summarizes significant fiscal issues that may impact more than one agency or do not fall into the jurisdiction of a single fiscal subcommittee.

The analysis has six components, listed here and described further below:

- Budget Overview
- Other Fiscal Issues
- Tax Policy and Initiatives
- Revenue
- Agency Budget Analysis
- Reference

An additional component, an explanation of adjustments made to actual fiscal 1994 expenditures and fiscal 1995 appropriations to derive the 1995 biennium base, is included in a companion volume.

Budget Overview

This section provides an overview of the state fiscal outlook, including a general fund and other revenue summary. It also includes an overview of the Executive Budget, and is designed to provide a context in which the reader may examine the Executive Budget and other major fiscal issues. It provides an analysis of the Executive Budget on a statewide level, evaluating and summarizing the major revenue and expenditure proposals and key executive policy

direction. In addition to discussing LFA issues, this section is designed to provide the reader with a summation and overview of the issues and policies generally discussed in greater detail, by agency, in the "Agency Budget Analysis" section published in Volumes I and II.

Other Fiscal Issues

Other fiscal issues are raised and discussed in this section that may not be specifically addressed in the Executive Budget but which either have emerged or have the potential to emerge in this or future biennia.

Tax Policy and Initiatives

This section provides a summarization and review of the tax proposals and revenue initiatives included in the Executive Budget.

Revenue

The "Revenue" section provides a summary and overview of major revenue sources to the state, including general fund, school equalization account and trust funds. The section also includes a discussion of the economic assumptions used to derive the revenue estimates established for use in the legislative session by the Revenue Oversight Committee (ROC).

Agency Budget Analysis

Within this section, sub-sections A through E include the LFA analysis of the Executive Budget for each agency and agency program. Each sub-section includes a number of state agencies organized by functional grouping corresponding to the appropriations subcommittee. Each agency and program includes the base budget, a delineation of adjustments made to the base by the executive to determine the present law budget, and all executive, legislative branch, elected officials, and Board of Regents new proposals. LFA issues with any component of the Executive Budget are raised and discussed. The analysis also includes a discussion of issues not directly related to the Executive Budget, as appropriate. This section is also intended to be a working document for joint appropriations subcommittees review and action on the

INTRODUCTION

General Appropriations Act. A more detailed explanation of the components of this analysis is included in that section's introduction, Volume I.

Reference

The final section of the analysis is an overview of budget basics, including budget terms and concepts. It is designed to provide the reader with a basic grounding with which to read and understand the budget terms and concepts used or referred to in the budget analysis.

HB 7 - Revised Budget Process

During the 1993 Special Session, the legislature passed HB 7, which made adjustments to the budget development process. Although the statutory changes in HB 7 are primarily a minor re-definition of budget terms and timelines for submission of the Executive Budget, the expectations expressed during debate on HB 7 indicated a desire for fundamental change in the budget review process. HB 7 provides only a basic framework, leaving a wide range of options for the specifics of budget development and presentation. The passage of HB 7 provides an opportunity for a fresh look at the budget process and the potential for improvements in both the type of data provided to the legislature and the way the data is presented.

Since the early 1970s, budgets have been presented in two tiers: 1) current level, which was statutorily defined as the "level of funding required to maintain operations and services at the level authorized by the previous legislature, after adjustment for inflation"; and 2) modified level, defined as "the current funding level as adjusted to reflect workload increases, the provision of new services, or changes in authorized funding." While the LFA analysis and the Executive Budget have always provided the budget base (first year actual expenses of the prior biennium) and the major changes made to the budget base to derive the current level base, those changes did not become the basis for detailed committee review and action. The primary sponsors and proponents of HB 7 argued that the differences between the executive current level budget and the LFA current level analysis became the focus of legislative discussion, and as a result, the

current level base was the starting point for legislative review.

Debate on HB 7 emphasized the perception that the legislature did not have the opportunity to consider the adjustments made to derive current level funding. To address the issue, the two-tier approach was replaced with a three-tier approach. The three tiers are as follows: 1) The definition of base budget was added to statute as "that level of funding authorized by the previous legislature"; 2) present law base is defined as "that additional level of funding needed under present law to maintain operations and services at the level authorized by the previous legislature..."; and, 3) new proposals are defined as "requests to provide new non-mandated services, to change program services, to eliminate existing services, or to change sources of funding...". Present law base adjustments, when added to the budget base, result in a present law budget that is comparable to "current level funding." New proposals are comparable to "modified level funding."

In addition, HB 7 requires the LFA budget analysis and the Executive Budget to use the base budget, the present law base, and new proposals in their budget presentations. Consequently, HB 7 more specifically directs the type of budget information that must be provided to the legislature. The LFA 1997 Biennium Budget Analysis, Volumes I and II have been expanded to include a detailed discussion of the present law adjustments. This will provide the legislature the opportunity to use the base budget as the starting point for legislative review.

LFA Analysis and Presentation

Statute requires the LFA to provide an analysis of the Executive Budget for presentation to the legislature. A constraint of the former budget process was that the statutory timeframes for receipt of the Executive Budget (one month prior to the legislative session) did not allow adequate time for an in-depth analysis that budget. Instead, the LFA developed a separate current level estimate that was then compared to the executive proposal. With the new revised timeframes contained in HB 7, the opportunity existed to significantly change the emphasis and content of the LFA budget analysis.

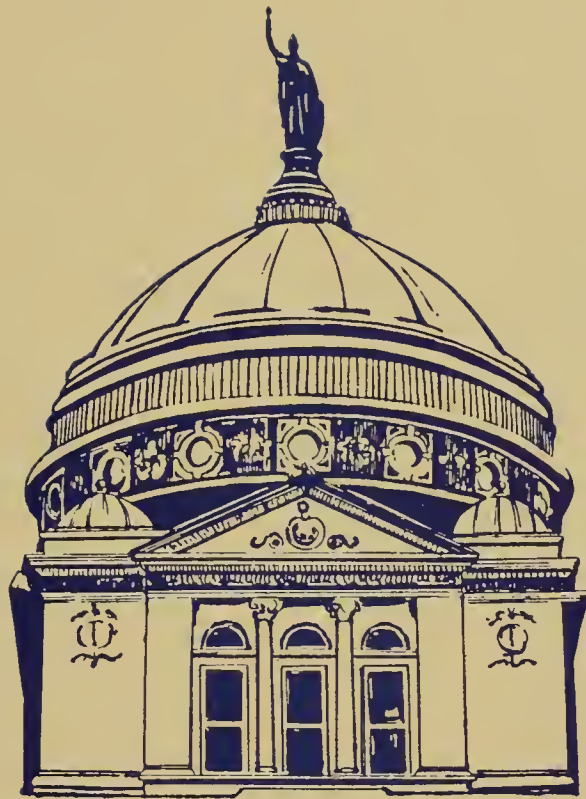
The LFA analysis does not contain a separate present law budget option as in the past, but focuses instead on an analysis of the Executive Budget.

INTRODUCTION

Impacts on Legislative Budget Review

The revised budget development process changes the information that is available for legislative review, and may require changes in the budget adoption process. The use of the base budget as the starting point for legislative review will mean an additional level of budget review during the legislative process that has not been addressed in any detail in past bienniums. This review could add a significant workload on appropriations committees and subcommittees, and may require scheduling and workload changes.

INTRODUCTION



BUDGET OVERVIEW

STATE FISCAL OUTLOOK

Projected Balances In Major State Accounts

The 1995 legislature faces a significantly different financial situation than in previous biennia. Three of the major accounts in state government have combined projected balances of \$124.7 million by the end of the 1997 biennium, as Table 1 shows. These balances are based on revenue estimates adopted by the Revenue Oversight Committee (ROC) on November 30, 1994, and anticipated spending for present law budgets as proposed by the executive. While the executive present law recommendations include funds for increased enrollment in public schools and higher human service and prison caseloads, funding for executive new proposals, such as state employee pay increases, increased state equalization aid, and provider rate increases, are excluded. A summary of the Executive Budget new proposals are shown on page Overview 20.

Table 1
Projected Balance
in Major State Accounts
1997 Biennium (Millions)

Account	Balance
General Fund	\$65.7
School Equalization Aid	0.0
Highways Special Revenue	59.0
Totals	\$124.7

Montana's current budget situation is a welcome relief as compared to previous biennia. While the state's financial picture has been bleak for almost a decade, a significant improvement has occurred during the past year. A relentless structural imbalance between revenues and expenditures in the general fund and school equalization (SEA) accounts has been looming since fiscal 1984. In the general fund, expenditures have exceeded revenues for 7 of the last 11 years, as Table 2 shows. In the SEA, expenditures have exceeded revenues in 8 of these years. To maintain solvency in these accounts and fund the ongoing costs of state government and state support for public schools, the legislature transferred \$107.1 million from other accounts to the general fund and SEA during the period 1986 through 1993. In addition, a number of "one-time" accelerations of revenue collections--\$17.0 million in corporation taxes, \$32.5 million in individual income taxes, \$42.5 million in additional revenue accruals -- temporarily increased revenues. These "one-time" revenues were used to fund ongoing expenses of state government. As a result, the imbalance between current level costs and available revenues grew.

STATE FISCAL OUTLOOK

Table 2
Revenue and Disbursement History
General Fund & School Equalization
In Millions

F Y	General Fund Revenue	General Fund Disburse.	Surplus / Deficit	School Equalization Revenue	School Equalization Disburse.	Surplus / Deficit
A 84	\$330.305	\$357.387	(\$27.082)	\$242.384	\$261.753	(\$19.369)
A 85	364.522	380.359	(15.837)	281.275	271.016	10.259
A 86	349.541	366.815	(17.274)	252.899	282.166	(29.267)
A 87	346.690	391.325	(44.635)	263.052	283.428	(20.376)
A 88	391.152	370.853	20.299	276.216 *	281.886	(5.670)
A 89	411.729	388.270	23.459	275.589 *	279.536	(3.947)
A 90	447.962	432.323	15.639	282.389	287.393	(5.004)
A 91	420.257	457.612	(37.355)	385.031	391.500	(6.469)
A 92	487.036	523.072	(36.036)	393.591 *	398.059	(4.468)
A 93	539.955	523.553	16.402	412.903	405.067	7.836
A 94	480.021	497.921	(17.900)	411.834	406.388	5.446

* Excludes education trust & general fund transfers.

In the highways state special revenue account (HSRA), expenditures have exceeded revenues in 7 of the last 12 years. While the legislature increased motor fuel taxes in 1983, 1986, 1987, 1994, and 1995 and allocated 12 percent of total coal tax collections to the highway program, expenditures have increased more quickly than revenues. During the last two biennia, the highway program has spent an average \$20 million more per year than revenue collections.

This biennium, revenues to the HSRA have exceeded 1993 legislative estimates by \$28.2 million. The fund balance in the account increased to \$76.7 million at the

end of fiscal 1994 and is projected to be \$78.6 million by the end of fiscal 1995. Because of the improved revenue situation, however, the Department of Transportation plans to reduce long-term debt by \$40 million in fiscal 1995. This action will reduce the fund balance in the HSRA to \$38.6 million by the end of fiscal 1995.

Using the executive present law budget recommendations for the 1997 biennium, the fund balance in the HSRA at the end of fiscal 1997 will be \$59 million. This balance does not include any of the executive new proposals.

STATE FISCAL OUTLOOK

1995 Biennium General Fund / SEA Outlook

After completion of the November 1993 special legislative session, the general fund balance was projected to be \$24.4 million. This balance was based on: 1) revenue estimates adopted in HJR 2; 2) LFA statutory appropriation projections; and 3) all general fund appropriations authorized by the legislature. The Fifty-third legislature assumed there would not be any supplementals requested during the 1995 biennium.

As Table 3 shows, the revised general fund balance at the end of the 1995 biennium is projected to be \$34.1 million. Deducted from this total is a \$10.0 million appropriation to the capital projects fund (See Volume II, page F-8) as authorized in HB 5 of the 1993 regular legislative session.

STATE FISCAL OUTLOOK

Table 3
Comparison of 1995 Biennium General Fund/SEA Balance
(In Millions)

Fund Balance Item	November 1993 Special Session	January 1995 LFA Budget Analysis	Differences
Beginning Fund Balance	\$52.2	\$52.2	\$0.0
Estimated Revenues			
General Fund	1,083.3	1,122.2	38.9
School Equalization Account	690.7	704.1	13.4
Total Revenue	\$1,774.0	\$1,826.4	\$52.4
Total Rev. Available	\$1,826.2	\$1,878.5	\$52.4
Estimated Disbursements			
State Agencies & University System	\$926.7	\$937.4	\$10.6
School Equalization Account			
Direct State Aid	539.4	539.1	(0.3)
Guaranteed Tax Base	262.9	265.1	2.2
Transportation	7.8	7.8	0.0
Other	2.5	4.1	1.7
Total SEA	\$812.5	\$816.1	\$3.6
Statutory Appropriations			
Personal Property Reimbursement	36.7	36.8	0.1
Debt Service	20.5	27.1	6.6
TRANS	4.2	4.9	0.6
Other	9.2	8.4	(0.8)
Total Statutory	\$70.6	\$77.1	\$6.5
Legislative Session Costs	5.7	5.3	(0.4)
Supplementals	0.0	16.5	16.5
Reversions	(10.0)	(5.2)	4.8
Total Disbursements	\$1,805.6	\$1,847.2	\$41.6
Adjustments	3.4	10.2	6.8
Residual Equity Transfer	0.4	2.5	2.0
Capital Projects Transfer	0.0	(10.0)	(10.0)
Ending Fund Balance	\$24.4	\$34.1	\$9.6

STATE FISCAL OUTLOOK

The revised projection of the general fund balance is based on: 1) revenue estimates adopted by ROC in November 1994; 2) LFA statutory appropriation projections; and 3) the executive supplemental appropriation recommendations. This projected balance equals 1.9 percent of anticipated revenues for the 1995 biennium.

The improvement in the general fund balance is because of greater revenue collections in fiscal 1994 and higher revenue forecasts for fiscal 1995. For a detailed discussion see the "Revenue" section, Volume I. While 1995 biennium general fund/SEA revenues are expected to be \$52.4 million more than anticipated by the Fifty-third legislature, total disbursements are expected to be \$41.6 above the budgeted level. The main reasons for the increased disbursements are: 1) proposed supplemental appropriations of \$16.5 million; 2) emergency appropriations of \$8.3 million; 3) additional debt service costs of \$6.6 million; 4) higher school equalization aid costs of \$3.6 million; and 5) lower reversions of \$4.8 million. As Table 3 shows, the combined impact of higher revenues and greater disbursements is a net improvement of \$9.6 million for the 1995 biennium.

General Fund/SEA Revenue Estimates

On November 30, 1994, ROC met to formally adopt economic assumptions relevant to the development of revenue estimates for fiscal 1995, 1996, and 1997. These assumptions were used by the LFA to generate the general fund and SEA revenue estimates shown in Tables 4 and 5. Actual fiscal 1994 collections are shown, along with projections for fiscal 1995 through 1997. In accordance with 5-18-107, MCA, these estimates "constitute the legislature's current revenue estimate until amended or until final adoption of the estimate by both houses." A complete discussion of the economic assumptions and the major general fund and SEA revenue sources are included in the "Revenue" section of the LFA 1997 Biennium Budget Analysis, Volume I.

STATE FISCAL OUTLOOK

Table 4
General Fund Revenue Estimates
Figures In Millions

Source of Revenue	Actual Fiscal 94	Estimated Fiscal 95	Estimated Fiscal 96	Estimated Fiscal 97	Estimated FY 94-95	Estimated FY 96-97
Individual Income Tax	\$207.011	\$338.062	\$358.453	\$374.788	\$545.073	\$733.241
Corporation License Tax	37.550	59.303	62.477	66.079	96.853	128.556
Coal Severance Tax	6.351	6.883	6.903	6.519	13.234	13.422
Oil Severance Tax	12.093	10.984	10.632	10.827	23.077	21.459
Interest on Investments	11.776	14.884	15.591	15.668	26.660	31.259
Long-Range Bond Excess	49.215	48.612	50.910	52.909	97.827	103.819
Coal Trust Interest Income	35.466	35.536	35.532	35.881	71.002	71.413
Insurance Premiums Tax	22.511	24.087	25.108	26.040	46.598	51.148
Public Institutions Reimbursement	15.415	15.881	16.449	16.359	31.296	32.808
Liquor Profits	3.438	3.261	4.235	4.271	6.699	8.506
Liquor Excise Tax	6.324	6.275	6.360	6.452	12.599	12.812
Inheritance Tax	10.886	11.176	11.500	11.804	22.062	23.304
Metal Mines Tax	3.613	2.984	3.266	3.080	6.597	6.346
Electrical Energy Tax	3.728	4.076	4.146	4.196	7.804	8.342
Drivers' License Tax	1.855	2.138	2.149	2.165	3.993	4.314
Telephone License Tax	6.835	4.023	4.072	4.127	10.858	8.199
Beer License Tax	1.376	1.380	1.391	1.391	2.756	2.782
Natural Gas Severance Tax	1.311	1.465	1.531	1.634	2.776	3.165
Railroad Car Tax	0.067	0.000	0.000	0.000	0.067	0.000
Wine Tax	0.764	0.733	0.707	0.681	1.497	1.388
Video Gaming Income Tax	9.955	10.991	11.994	13.143	20.946	25.137
Motor Vehicle Account	9.721	9.980	10.246	10.520	19.701	20.766
Vehicle Fees	3.704	3.887	4.055	4.208	7.591	8.263
Public Contractor's Tax	0.964	0.967	1.067	1.011	1.931	2.078
Other Revenue Sources	18.094	24.653	16.065	16.770	42.747	32.835
Grand Total	\$480.023	\$642.221	\$664.839	\$690.523	\$1,122.244	\$1,355.362

STATE FISCAL OUTLOOK

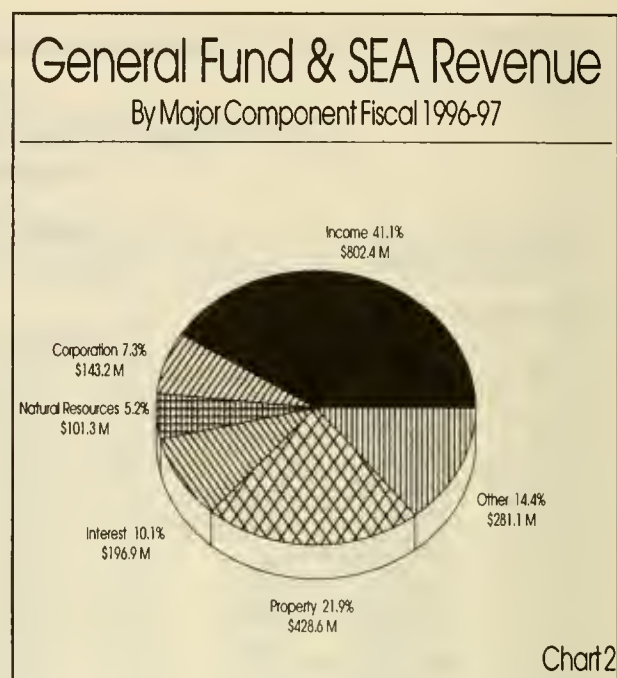
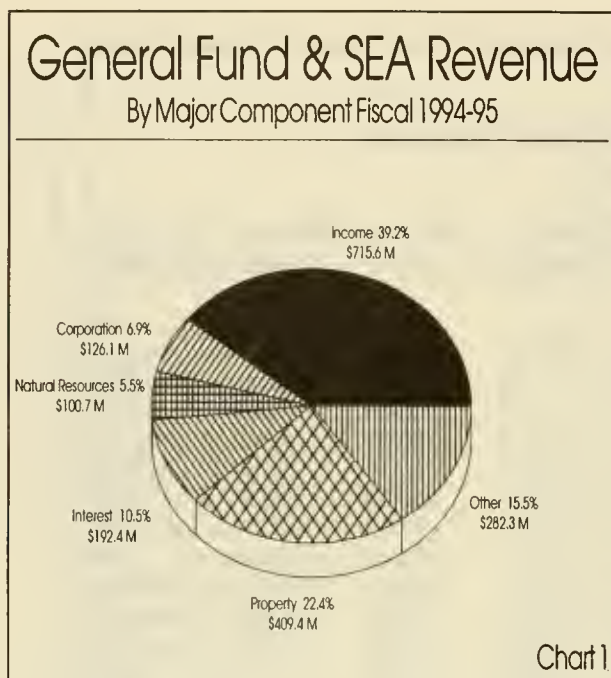
Table 5
School Equalization Account Revenue Estimates
Figures In Millions

Source of Revenue	Actual Fiscal 94	Estimated Fiscal 95	Estimated Fiscal 96	Estimated Fiscal 97	Estimated FY 94-95	Estimated FY 96-97
State Revenue						
Individual Income Tax	\$108.667	\$0.000	\$0.000	\$0.000	\$108.667	\$0.000
Corporation License Tax	16.447	0.000	0.000	0.000	16.447	0.000
Coal Severance Tax	4.695	5.098	5.114	4.829	9.793	9.943
Coal Tax Trust Interest	6.259	6.271	6.270	6.332	12.530	12.602
Interest & Income	40.944	40.796	39.755	41.515	81.740	81.270
US Oil & Gas Royalties	22.052	23.165	23.787	23.209	45.217	46.996
Education Trust Interest	0.066	0.166	0.106	0.069	0.232	0.175
SEA Interest	0.095	0.095	0.095	0.095	0.190	0.190
County Revenue *	124.671	127.231	129.349	132.659	251.902	262.008
Statewide 40 Mills	77.685	79.792	82.078	84.469	157.477	166.547
Lottery	8.524	8.678	8.842	9.005	17.202	17.847
Miscellaneous	1.704	1.000	0.345	0.179	2.704	0.524
County Levy Surplus	0.025	0.000	0.000	0.000	0.025	0.000
Total State	\$411.834	\$292.292	\$295.741	\$302.361	\$704.126	\$598.102
Statewide Taxable Valuation	\$1,707.993	\$1,763.019	\$1,814.833	\$1,869.654	NA	NA
* County Revenue Detail						
Statewide 55 Mills	94.239	97.088	99.931	102.953	191.327	202.884
Elementary Transportation	0.000	0.000	0.000	0.000	0.000	0.000
Cash Reappropriated	0.323	0.000	0.000	0.000	0.323	0.000
Forest Funds	2.608	2.725	2.283	2.238	5.333	4.521
Taylor Grazing	0.143	0.147	0.146	0.146	0.290	0.292
Miscellaneous	28.999	28.237	27.956	28.290	57.236	56.246
High School Tuition	(0.968)	(0.968)	(0.968)	(0.968)	(1.936)	(1.936)
Other Adjustments	(0.673)	0.000	0.000	0.000	(0.673)	0.000
Total County	\$124.671	\$127.229	\$129.348	\$132.659	\$251.900	\$262.007
Total General Fund/School Equalization	\$891.857	\$934.513	\$960.580	\$992.884	\$1,826.370	\$1,953.464

Beginning in fiscal 1995, personal income tax and corporate income tax collections are no longer distributed to the SEA as a result of SB 378 passed by the 1993 legislature. Consequently, the majority of these revenue collections are deposited directly into the general fund (91.3 percent of personal income tax and 89.5 percent of corporate income tax). Because of this

change, the general fund and SEA accounts have been combined in Charts 1 and 2 to show the revenue contribution of the major revenue components. During the 1997 biennium over 70 percent of total revenue will come from income and property taxes while 10 percent will be generated from investment earnings.

STATE FISCAL OUTLOOK



1997 Biennium General Fund/SEA Outlook

Table 6 shows the projected fund balance statement for the combined general fund and SEA accounts for the 1997 biennium. Figures shown are as recommended by the executive, exclusive of any new proposals, compared to the findings developed during the LFA budget analysis. In both cases, the disbursement amounts shown are present law estimates and do not include any new proposals.

The 1997 biennium ending fund balance as projected by the executive is \$101.7 million. The LFA present law estimate is \$65.6 million for a difference of \$36.0 million. The primary reasons for the difference are: 1) the LFA's beginning fund balance is expected to be \$21.7 million less; 2) total revenues are estimated to be \$11.5 million less; and 3) disbursements are estimated to be \$0.4 million higher.

Total available revenues for the 1997 biennium (beginning fund balance plus estimated revenues) are less than the executive because of ROC's recommendation to exclude litigated rail car taxes from executive's non-inclusion of the \$10 million capital projects fund appropriation (HB 5). Disbursement variations are primarily due to different estimates of SEA and debt service costs.

The LFA projection of the combined general fund and SEA present law account balance is based on: 1) the revenue estimates adopted by the Revenue Oversight Committee; 2) the 1997 biennium executive recommendations for present law budgets; 3) the LFA estimates of statutory appropriations; and 4) the executive supplemental recommendations for fiscal 1995. The projected balance does not include any funds for income tax refunds/rebates, state employee pay increases, or any other new proposals contained in the Executive Budget. The projected \$65.7 million balance equals 3.4 percent of anticipated revenues for the 1997 biennium.

STATE FISCAL OUTLOOK

Table 6
Comparison of 1997 Biennium General Fund/SEA Balance
Executive Budget vs. LFA Budget Analysis
(In Millions)

Fund Balance Item	Executive Budget 1997 Biennium	LFA Budget Analysis 1997 Biennium	Differences
Beginning Fund Balance	\$55.7	\$34.1	(\$21.7)
Estimated Revenues			
General Fund	1,374.2	1,355.4	(18.8)
School Equalization Account	590.8	598.1	7.3
Total Revenue	\$1,964.9	\$1,953.5	(\$11.5)
Total Rev. Available	\$2,020.7	\$1,987.5	(\$33.1)
Estimated Disbursements			
State Agencies & University System	\$1,016.8	\$1,016.8	\$0.0
School Equalization Account			
Direct State Aid	547.9	546.2	(1.7)
Guaranteed Tax Base	283.3	285.2	2.0
Transportation	7.8	7.8	0.0
Other	1.6	3.8	2.2
Total SEA	\$840.6	\$843.1	\$2.5
Statutory Appropriations			
Personal Property Reimbursement	36.8	36.8	0.0
Debt Service	13.3	11.7	(1.6)
TRANS	4.2	4.6	0.4
Other	10.3	9.2	(1.2)
Total Statutory	\$64.6	\$62.2	(\$2.4)
Legislative Session Costs	5.0	5.4	0.4
Supplementals	0.0	0.0	0.0
Reversions	(5.0)	(5.0)	0.0
Total Disbursements	\$1,922.0	\$1,922.4	\$0.4
Adjustments	0.0	(2.3)	(2.3)
Residual Equity Transfer	3.0	2.9	(0.1)
Capital Projects Transfer	0.0	0.0	0.0
Ending Fund Balance	\$101.7	\$65.7	(\$36.0)

STATE FISCAL OUTLOOK

If the executive's general fund and SEA account new proposals of \$76.6 million are included in the LFA fund balance statement, then the projected ending fund balance would be negative \$10.9 million. Included in the \$76.6 million total, however, is a \$25 million individual income tax refund recommendation. The Executive Budget indicates the refund would be based on the amount of the general fund balance above \$24 million ("We propose an income tax refund as the mechanism for returning general fund collections in excess of the \$24 million budgeted ending fund balance.")

Since the LFA analysis shows a \$34.1 million general fund balance at the end of fiscal 1995, the refund mechanism advocated by the executive would reduce total refunds from \$25 million (executive proposal) to approximately \$9.6 million. This reduction would modify the projected ending fund balance from a negative \$10.9 million to positive \$4.5 million. These calculations are shown in Table 7.

Table 7
Projected General Fund Ending Balance
Present Law Plus Executive New Proposals
(In Millions)

	Before Refund Adjustment	After Refund Adjustment
LFA Present Law Ending Fund Balance	\$65.7	\$65.7
Executive Proposals		
Individual Income Tax Refund	(\$25.0)	(\$9.6) ¹
All Other Proposals	(51.6)	(51.6)
Total Executive Proposals	(76.6)	(61.2)
Projected Total Ending Fund Balance	(\$10.9)	\$4.5
¹ Fund Balance Estimated to Exceed \$24.4 million.		

STATE FISCAL OUTLOOK

Tables 8 and 9 show the detail projected cash and fund balances for general fund and SEA accounts, respectively.

Table 8
Estimated General Fund Balance
Figures In Millions

	Actual Fiscal 1994	Estimated Fiscal 1995	Estimated Fiscal 1996	Estimated Fiscal 1997	Estimated Fiscal 94-95	Estimated Fiscal 96-97
Beginning Fund Balance	\$41.471	\$32.771	\$34.065	\$43.297	\$41.471	\$34.065
Receipts						
Estimated Receipts	480.021	642.221	664.839	690.523	1,122.242	1,355.362
Total Available	\$521.492	\$674.992	\$698.904	\$733.820	\$1,163.713	\$1,389.427
Disbursements						
General Appropriations	463.504	447.548	503.797	512.970	911.052	1,016.766
School Equalization Account	0.000	99.137	121.735	123.271	99.137	245.006
Language Appropriations	0.000	0.000	0.000	0.000	0.000	0.000
Pay Plan Appropriations	0.000	4.875	0.000	0.000	4.875	0.000
Statutory Appropriations	0.000	0.000	0.000	0.000	0.000	0.000
Property Tax Reimbursement	18.383	18.383	18.383	18.383	36.766	36.766
Debt Service	12.706	14.428	7.682	3.981	27.134	11.663
TRANS Interest	2.275	2.582	2.233	2.343	4.857	4.576
Retirement Benefits	0.000	0.000	0.000	0.000	0.000	0.000
District Court Reimbursement	3.008	3.887	4.055	4.208	6.895	8.263
Depository Banking Services	0.556	0.803	0.400	0.400	1.359	0.800
DUI Testing Equipment	0.050	0.050	0.050	0.050	0.100	0.100
Disaster/Emergency	0.108	8.271	0.000	0.000	8.379	0.000
Miscellaneous Appropriations	0.000	3.699	0.000	0.000	3.699	0.000
Continuing Appropriations	0.000	9.380	0.000	0.000	9.380	0.000
Supplementals	0.000	0.000	0.000	0.000		
All Other Agencies	0.000	16.461	0.000	0.000	16.461	0.000
School Equalization Account	0.000	0.000	0.000	0.000	0.000	0.000
Feed Bill	0.000	5.275	0.000	5.407	5.275	5.407
Reversions	(2.669)	(2.500)	(2.500)	(2.500)	(5.169)	(5.000)
Anticipated Disbursements	\$497.921	\$632.279	\$655.835	\$668.513	\$1,130.200	\$1,324.347
Adjustments	7.724	0.372	(1.203)	(1.100)	8.096	(2.303)
State Equalization Reversion	0.000	0.000	0.000	0.000	0.000	0.000
Residual Equity Transfer	1.476	0.980	1.431	1.476	2.456	2.907
Ending Fund Balance	<u>\$32.771</u>	<u>\$34.065</u>	<u>\$43.297</u>	<u>\$65.683</u>	<u>\$34.065</u>	<u>\$65.683</u>
Ending Cash Balance	<u>\$42.669</u>	<u>\$43.962</u>	<u>\$53.195</u>	<u>\$75.581</u>	<u>\$43.962</u>	<u>\$75.581</u>
Capital Projects Transfer	NA	\$10.000	NA	NA	\$10.000	NA

STATE FISCAL OUTLOOK

Table 9
Estimated School Equalization Account Balance
Figures In Millions

	Actual Fiscal 1994	Estimated Fiscal 1995	Estimated Fiscal 1996	Estimated Fiscal 1997	Estimated Fiscal 94-95	Estimated Fiscal 96-97
Beginning Fund Balance	\$10.706	\$17.109	\$0.000	\$0.000	\$10.706	\$0.000
Receipts						
Estimated Receipts	411.834	292.292	295.740	302.360	704.126	598.100
Total Available	\$422.540	\$309.401	\$295.740	\$302.360	\$714.832	\$598.100
Disbursements						
Current Level Schedules	271.766	267.313	271.225	275.011	539.079	546.236
Guaranteed Tax Base	128.575	136.496	140.442	144.806	265.071	285.248
Transportation Costs	3.908	3.914	3.908	3.914	7.822	7.822
OPI Administration	0.322	0.078	0.000	0.000	0.400	0.000
Telecommunications Network	0.177	0.223	0.200	0.200	0.400	0.400
SIMMS	0.500	0.500	0.500	0.500	1.000	1.000
Childrens Treatment	0.000	0.000	0.000	0.000	0.000	0.000
Bonus Payments	0.000	0.000	0.000	0.000	0.000	0.000
Other Costs	1.140	1.200	1.200	1.200	2.340	2.400
Anticipated Disbursements	\$406.388	\$409.724	\$417.475	\$425.631	\$816.112	\$843.106
Adjustments	0.957	1.186	0.000	0.000	2.143	0.000
Residual Equity Transfer	0.000	0.000	0.000	0.000	0.000	0.000
General Fund Transfer	0.000	99.137	121.735	123.271	99.137	245.006
Ending Fund Balance	<u>\$17.109</u>	<u>\$0.000</u>	<u>\$0.000</u>	<u>\$0.000</u>	<u>\$0.000</u>	<u>\$0.000</u>
Ending Cash Balance	<u>\$8.873</u>	<u>(\$8.236)</u>	<u>(\$8.236)</u>	<u>(\$8.236)</u>	<u>(\$8.236)</u>	<u>(\$8.236)</u>

EXECUTIVE BUDGET ANALYSIS - SUMMARY

Introduction

As outlined in the preceding section, an improved revenue picture as well as the implementation of policy initiatives adopted by the last legislature, has brightened the general fund financial outlook for the 1997 biennium. This prognosis provides the opportunity for the Fifty-fourth Legislature to address budget issues without the significant general fund budget deficit problem that has plagued Montana for the past several biennia. This section examines the Governor's response to the state's fiscal outlook and attempts to characterize the Governor's budget proposals into major categories. Budget comparisons to the current biennium are provided, as is a review and discussion of some of the major policy changes and issues in the Executive Budget.

The Governor has responded to the improved revenue outlook with a budget proposal that calls for a significant increase in general fund and total state spending, funded primarily with existing sources of revenue. Except for the recommended individual income tax rebate/refund during fiscal 1996 there are only minor tax policy initiatives in the Executive Budget.

Comparison to 1995 Biennium

The Executive Budget recommends \$150.5 million increased general fund expenditures for the 1997 biennium as compared to the 1995 biennium, or an increase of 16.6 percent. The total of additional funds requested is \$621.5 million, an increase of 18.9 percent. When the 1997 biennium executive pay plan proposal and other non-agency specific executive proposals are added, the general fund increase is 19.1 percent and total funds increase is 20.1 percent, as shown at the bottom of Tables 1 and 2.

Tables 1 and 2 show the increase by agency from the 1995 to 1997 biennium for general fund and total funds. As shown in the tables, the increases are dispersed throughout most agencies, although the largest increases are in human service and transportation agencies.

EXECUTIVE BUDGET ANALYSIS - SUMMARY

General Fund Comparison 95 Biennium Versus Executive Budget 97 Biennium								
Agcy Code	Agency Name	Total Budget Fiscal 94-95	Present Law Exec. Budget Fiscal 96-97	Percent Change 95B to 97B	New Proposals Fiscal 96-97	Total Exec. Budget Fiscal 96-97	Percent Change 95B to 97B	Difference 97 Biennium - 95 Biennium
1101	Legislative Auditor	\$2,566,515	\$2,977,362	16.01%	\$0	\$2,977,362	16.01%	\$410,847
1102	Legislative Fiscal Analyst	1,619,761	1,656,301	2.26%	0	1,656,301	2.26%	36,540
1104	Legislative Council	3,840,016	4,345,613	13.17%	1,312,553	5,658,166	47.35%	1,818,150
1111	Environmental Quality Council	550,410	615,958	11.91%	0	615,958	11.91%	65,548
2110	Judiciary	10,838,601	11,585,483	6.89%	(47,721)	11,537,762	6.45%	699,161
3101	Governors Office	4,469,902	5,079,687	13.64%	(32,883)	5,046,804	12.91%	576,902
3201	Secretary Of States Office	108,742	74,609	-31.39%	0	74,609	-31.39%	(34,133)
3202	Commissioner Of Political Prac	250,011	299,801	19.92%	0	299,801	19.92%	49,790
3401	State Auditors Office	3,984,336	4,492,899	12.76%	(483,322)	4,009,577	0.63%	25,241
3501	Office Of Public Instruction	87,065,101	93,628,544	7.54%	194,581	93,823,125	7.76%	6,758,024
4107	Crime Control Division	925,086	971,315	5.00%	0	971,315	5.00%	46,229
4108	Highway Traffic Safety	361,397	500,000	38.35%	0	500,000	38.35%	138,603
4110	Department Of Justice	22,472,592	28,899,057	28.60%	3,019,898	31,918,955	42.04%	9,446,363
5100	University System	215,472,715	220,199,279	2.19%	1,265,966	221,465,245	2.78%	5,992,530
5101	Board Of Public Education	217,721	232,950	6.99%	0	232,950	6.99%	15,229
5113	School For The Deaf & Blind	5,075,167	5,560,035	9.55%	146,822	5,706,857	12.45%	631,690
5114	Montana Arts Council	243,178	235,499	-3.16%	170,920	406,419	67.13%	163,241
5115	Library Commission	2,119,804	2,492,684	17.59%	355,400	2,848,084	34.36%	728,280
5117	Historical Society	2,639,182	2,760,169	4.58%	(118,728)	2,641,441	0.09%	2,259
5201	Dept Of Fish, Wildlife & Parks	563,961	538,617	-4.49%	32,000	570,617	1.18%	6,656
5301	Dept Health & Environ Sciences	6,697,935	8,322,482	24.25%	861,127	9,183,609	37.11%	2,485,674
5401	Department Of Transportation	60,709	0	-100.00%	400,000	400,000	558.88%	339,291
5501	Department Of State Lands	16,064,329	18,541,528	15.42%	(428,539)	18,112,989	12.75%	2,048,660
5603	Department Of Livestock	763,746	972,677	27.38%	(57,223)	915,454	19.86%	151,708
5706	Dept Nat Resource/Conservation	6,250,097	9,723,228	55.57%	(306,120)	9,417,108	50.67%	3,167,011
5801	Department Of Revenue	40,147,421	45,459,716	13.23%	(724,224)	44,735,492	11.43%	4,588,071
6101	Department Of Administration	7,078,689	6,497,414	-8.21%	926,796	7,424,210	4.88%	345,521
6201	Department Of Agriculture	889,320	917,402	3.16%	0	917,402	3.16%	28,082
6401	Corrections & Human Services	154,628,701	179,364,160	16.00%	16,374,037	195,738,197	26.59%	41,109,496
6501	Department Of Commerce	2,844,648	3,422,328	20.31%	(1,109)	3,421,219	20.27%	576,671
6602	Labor & Industry	1,599,753	1,691,653	5.74%	67,203	1,758,856	9.95%	159,103
6701	Dept Of Military Affairs	3,903,570	4,111,228	5.32%	268,679	4,379,907	12.20%	476,337
6901	Dept Social & Rehab Services	232,445,314	278,895,621	19.98%	4,498,649	283,394,270	21.92%	50,948,956
6911	Department Of Family Services	65,423,897	71,701,002	9.59%	10,257,089	81,958,091	25.27%	16,534,194
Totals		\$904,182,327	\$1,016,766,301	12.45%	\$37,951,851	\$1,054,718,152	16.65%	\$150,535,825
Other Executive Initiatives								
	GTB Debt Servie				1,500,000	1,500,000	NA	1,500,000
	Employee Pay Increase				16,065,000	16,065,000	NA	16,065,000
	Retiree Benefit Adjustment				4,970,000	4,970,000	NA	4,970,000
Grand Totals		\$904,182,327	\$1,016,766,301	12.45%	\$60,486,851	\$1,077,253,152	19.14%	\$173,070,825

EXECUTIVE BUDGET ANALYSIS - SUMMARY

All Budgeted Funds Comparison 95 Biennium Versus Executive Budget 97 Biennium							
Agcy Code	Agency Name	Total Budget Fiscal 94-95	Present Law Exec. Budget Fiscal 96-97	Percent Change 95B to 97B	New Proposals Fiscal 96-97	Total Exec. Budget Fiscal 96-97	Difference 97 Biennium - 95 Biennium
1101	Legislative Auditor	\$5,300,470	\$5,615,132	5.94%	\$0	\$5,615,132	\$314,662
1102	Legislative Fiscal Analyst	1,619,761	1,656,301	2.26%	0	1,656,301	36,540
1104	Legislative Council	5,204,637	5,764,506	10.76%	1,312,553	7,077,059	1,872,422
1111	Environmental Quality Council	564,224	644,041	14.15%	0	644,041	79,817
1112	Consumer Counsel	1,873,230	2,034,075	8.59%	0	2,034,075	160,845
2110	Judiciary	11,976,258	12,652,524	5.65%	129,534	12,782,058	805,800
3101	Governors Office	4,974,733	5,979,428	20.20%	(211,937)	5,767,491	792,758
3201	Secretary Of States Office	3,198,070	3,598,712	12.53%	531,970	4,130,682	932,612
3202	Commissioner Of Political Prac	250,011	299,801	19.92%	0	299,801	49,790
3401	State Auditors Office	6,327,929	7,460,754	17.90%	(220,574)	7,240,180	912,251
3501	Office Of Public Instruction	160,963,975	236,090,044	46.67%	7,284,283	243,374,327	82,410,352
4107	Crime Control Division	9,443,271	10,323,791	9.32%	1,060,465	11,384,256	1,940,985
4108	Highway Traffic Safety	2,722,514	9,695,156	256.11%	0	9,695,156	6,972,642
4110	Department Of Justice	63,739,298	69,047,606	8.33%	3,582,321	72,629,927	8,890,629
4201	Public Service Regulation	4,183,587	4,509,786	7.80%	(128,420)	4,381,366	197,779
5100	University System	435,297,405	456,706,121	4.92%	15,174,077	471,880,198	36,582,793
5101	Board Of Public Education	389,013	418,769	7.65%	0	418,769	29,756
5113	School For The Deaf & Blind	5,960,817	6,671,074	11.92%	(273,189)	6,397,885	437,068
5114	Montana Arts Council	1,455,789	1,581,389	8.63%	62,934	1,644,323	188,534
5115	Library Commission	4,168,013	6,472,398	55.29%	582,205	7,054,603	2,886,590
5116	Vocational Education Council	321,402	335,178	4.29%	0	335,178	13,776
5117	Historical Society	5,224,624	5,475,259	4.80%	163,640	5,638,899	414,275
5201	Dept Of Fish, Wildlife & Parks	69,266,277	74,543,969	7.62%	3,548,177	78,092,146	8,825,869
5301	Dept Health & Environ Sciences	110,359,504	123,809,285	12.19%	11,481,195	135,290,480	24,930,976
5401	Department Of Transportation	667,836,790	774,415,715	15.96%	41,968,491	816,384,206	148,547,416
5501	Department Of State Lands	40,384,882	48,654,834	20.48%	360,292	49,015,126	8,630,244
5603	Department Of Livestock	11,084,581	11,645,174	5.06%	(188,931)	11,456,243	371,662
5706	Dept Nat Resource/Conservation	24,292,494	26,752,836	10.13%	(131,192)	26,621,644	2,329,150
5801	Department Of Revenue	44,355,056	48,804,925	10.03%	(566,285)	48,238,640	3,883,584
6101	Department Of Administration	89,831,181	86,348,696	-3.88%	7,892,805	94,241,501	4,410,320
6103	State Compensation Ins. Fund	9,902,731	0	-100.00%	0	0	(9,902,731)
6104	Public Employees Retirement Bd	2,242,975	2,590,417	15.49%	(73,438)	2,516,979	274,004
6105	Teachers Retirement Board	1,288,541	1,449,664	12.50%	(33,650)	1,416,014	127,473
6201	Department Of Agriculture	15,686,023	16,310,035	3.98%	531,555	16,841,590	1,155,567
6401	Corrections & Human Services	186,605,942	213,563,599	14.45%	22,713,917	236,277,516	49,671,574
6501	Department Of Commerce	119,960,029	135,354,328	12.83%	1,194,076	136,548,404	16,588,375
6602	Labor & Industry	81,870,824	84,453,276	3.15%	(997,021)	83,456,255	1,585,431
6701	Dept Of Military Affairs	12,839,541	13,059,925	1.72%	8,128,724	21,188,649	8,349,108
6901	Dept Social & Rehab Services	959,802,595	1,099,414,778	14.55%	39,587,112	1,139,001,890	179,199,295
6911	Department Of Family Services	108,939,266	121,442,085	11.48%	13,096,354	134,538,439	25,599,173
Totals		\$3,291,708,263	\$3,735,645,386	13.49%	\$177,562,043	\$3,913,207,429	\$621,499,166
Other Executive Initiatives							
GTB Debt Servie					1,500,000	1,500,000	1,500,000
Employee Pay Increase					33,061,596	33,061,596	33,061,596
Retiree Benefit Adjustment					4,970,000	4,970,000	4,970,000
Grand Totals		\$3,291,708,263	\$3,735,645,386	13.49%	\$217,093,639	\$3,952,739,025	\$661,030,762

The method used to measure the increases was comparisons of the current biennium to the 1997 biennium. Current biennium budget figures consist of actual fiscal 1994 adjusted expenditure amounts and fiscal 1995 appropriated amounts. This comparison method follows the intent of "truth in budgeting" as stated in HB 7 and is similar to the process that was used to establish expenditure targets during the 1993 legislature. The Select Committee on Budget and Taxation used the 1993 biennium spending levels to

establish budget targets and also as the benchmark from which to measure change.

There is a one-time non-general fund accounting adjustment in the 1997 biennium of \$48 million in the Office of Public Instruction. If this one-time adjustment were excluded from the 1997 biennium totals, the total funds increase in Table 2 would be lowered to \$573 million, or 17.4 percent.

EXECUTIVE BUDGET ANALYSIS - SUMMARY

Of the total fund increase, the Executive Budget recommends increases of \$443.9 million for agency present law adjustments and \$177.6 million for new proposals. Of the general fund increase, the executive includes \$112.5 million for agency present law adjustments and \$38.0 million for new proposals. Table 3 shows all general fund new proposals included in the Executive Budget including revenue proposals. As shown in the table, the only significant revenue proposal is the individual income tax refund/rebate proposal.

The executive is proposing to refund/rebate any excess in the general fund cash over the budgeted \$24.4 million ending fund balance at the end of the 1995 biennium, to be distributed in fiscal 1996.

Revenue proposals are discussed further on page Overview 24.

Table 3
Executive Budget
Summary of General Fund/SEA New Proposals
Figures In Millions

Revenue Proposals	Fiscal 1996	Fiscal 1997	Biennium
Individual Income Tax Refund	(25.000)	0.000	(25.000)
Mezannine Financing	(0.039)	(0.075)	(0.114)
Microbusiness Loan Expansion	(0.024)	(0.057)	(0.081)
University System R&D Funding	(0.312)	(0.817)	(1.129)
Oil & Gas Taxation Reform	0.000	5.000	5.000
Coal Tax Diversion	5.200	0.000	5.200
Total Revenue Proposals	(\$20.175)	\$4.051	(\$16.124)
Disbursement Proposals	Fiscal 1996	Fiscal 1997	Biennium
Agency New Proposals	16.900	21.052	37.952
School Equalization Aid	0.500	1.000	1.500
Pay Plan Proposal	5.264	10.801	16.065
Retiree Benefit Adjustment	1.799	3.171	4.970
Total Disbursement Proposals	\$24.463	\$36.024	\$60.487
Grand Total All Proposals	(\$44.638)	(\$31.973)	(\$76.611)

The majority of the increased expenditures are directed to human service programs, expanding prison populations, funding increases for highway construction, and increased education costs, primarily due to enrollment growth in both K-12 and higher

education. Although general fund recommendations comprise 24 percent of the total increase, the largest increase is in federal funds, primarily due to additional highways funding and federal grants and benefits.

EXECUTIVE BUDGET ANALYSIS - SUMMARY

Executive Budget Priorities

The Executive Budget proposal essentially retains the same spending priorities for present law budgets as was reflected in the last biennium. The executive recommends adequate funding for all formula-driven programs such as K-12 education and other statutory obligations. Also included are additional funds needed due to legally mandated workload and caseload increases as reflected in most human services programs, including prison population driven expenses. Historically, these programs have been claiming an increasing slice of the general fund pie. There are, however, a number of issues presented in the agency budget analysis in Volumes I and II that question the level of funding for specific program costs. Options are presented in the LFA analysis that, if implemented, could provide significant dollar savings while maintaining the current level of service.

The executive is recommending some notable fiscal and policy directive proposals. The over \$210 million (including the executive pay plan) in total new proposals can be categorized by major functional type. These recommendations can be categorized as follows:

- Providing Individual Income Tax Relief;
- Reforming Human Services Programs;
- Managing Prison Population Growth;
- Prioritizing Building Construction and Renovation Needs;
- Increasing State Employee Pay; and
- Expanding Highway Construction.

Income Tax Refund

The executive proposes to refund \$25 to \$30 million of excess general fund balance during fiscal 1996 based on executive projections of fiscal 1995 ending fund balance. The total amount to be refunded to individual income taxpayers would be based on the general fund ending balance in excess of \$24 million --- the balance anticipated by the Fifty-third legislature.

Human Services Program Reforms

The executive funds a number of initiatives in the 1997 biennium designed to serve current or under-served human services clients or populations. In addition to

caseload and inflation growth, the major changes proposed by the executive for non-correctional human services generally fall into two categories: 1) reform and 2) services to youth currently not served or considered under-served.

The major reforms proposed by the executive are welfare reform and physical and mental health managed care. Both are designed to increase efficiency in the delivery of services and/or to control or reduce costs. The executive would provide significant increases in funding for programs designed to serve troubled youth, including Managing Resources Montana (MRM) for seriously emotionally disturbed youth, and community impact grant programs designed to serve youth prior to entering the juvenile justice or foster care system. In addition to these major reform initiatives, the executive includes increased funding for services provided to developmentally disabled individuals, through additional community services that continue youth de-institutionalization efforts began during previous biennia.

Prison Population Growth

The second major budget increase occurs in corrections. Anticipated 1995 biennium reductions in prison population did not materialize. The executive proposes significant increases to control institution populations and to expand community corrections programs, specifically to provide more pre-release center beds and more probation and parole officers.

Long Range Building Program - Deferred Maintenance

The executive recommends the largest long-range building program ever proposed, at a total cost of \$193.1 million. This proposal involves some new construction, but a significant portion of the recommendation addresses a backlog in deferred maintenance requests to repair rapidly deteriorating infrastructure. The most notable deferred maintenance proposal is \$18 million for capitol building restoration.

State Employee Pay Raise

The executive proposes a market based pay raise for state employees. The proposal would cost \$16.1 million

EXECUTIVE BUDGET ANALYSIS - SUMMARY

general fund and \$33.1 million in total funds. It addresses the market based pay plan concept adopted by the legislature in the 1991 session.

Highway Construction Expansion

The executive recommends a significant expansion of highway construction and related projects. This recommendation represents \$25 million for expansion of the state funded Reconstruction Trust Program for road construction, and an additional \$75 million in state/federal matching funds for an expanded highway construction program.

Executive Budget Concerns

The Executive Budget proposes several major policy recommendations, and in many cases, specific legislative action to accomplish the initiatives. However, there are two areas of concern with the Executive Budget.

Ending Fund Balance

The Executive Budget as presented provides a plan for a balanced general fund budget, with a proposed ending fund balance of \$25 million for the 1997 biennium. However, as shown in Table 6 on page Overview 13, the ending fund balance as adjusted based on ROC revenue estimates would be \$65.6 million if only present law services were funded. If all executive general fund new proposals were approved, there would be an ending fund balance of \$4.5 million: (after adjustment for a smaller income tax refund as described on page Overview 14). This is \$21.5 million short of the executive target ending fund balance of \$25 million. The differences between the executive proposal and the LFA analysis are explained in Table 6 on page 13.

The executive did not show the \$10.0 million general fund transfer to the capital projects fund, which accounts for a major portion of the difference.

ROC estimates further reduce the executive ending fund balance by an additional \$7.9 million. The majority of this difference is the proposed rail car tax receipts, which are currently being litigated. The Executive assumes the state will prevail in the lawsuit

and will recover the full amount contested by June 30, 1995. Since this assumption seemed overly optimistic based on current information, ROC did not include revenue estimates given the uncertainty of the timing and amount of the settlement from this tax during the 1997 biennium. The LFA will monitor this case closely and apprise the legislature of potential settlement prior to the end of the regular session.

While the executive proposal included a balanced budget prior to the ROC revenue adjustments, the proposed \$25 million reserve may be too small to cover the risk inherent in the budget plan. This issue is discussed further in the discussion on adequate fund balance reserves on page Overview 39.

Lack of Budget Detail

Major portions of the published Executive Budget are presented in outline form, with the substance to be filled in later. The Executive Budget provides little explanation of the policies needed to implement in the proposed changes or of the mechanics of implementing the initiatives. Examples follow:

- Tax Policy Initiatives - The printed Executive Budget did not address the new tax initiatives in any detail, with the exception of the income tax refund, and in that case, the method of refunding was undetermined. LFA inquiries about the tax proposals determined that the proposals were not yet fully developed, and that the amounts shown in the Executive Budget were only preliminary estimates.

- Executive Pay plan - The final pay plan methodology is subject to union negotiations. The allocation of the pay plan was not included in the Executive Budget, even though statutorily required, and the allocations provided subsequently represented only estimates. See the discussion of this issue on page Overview 43.

- Human Services Proposals - The executive is offering several major initiatives in human services, including welfare reform, community impact grants, mental and physical health managed care, and the Wilderness Camp proposal in DFS. However, some of the most significant initiatives do not have adequate documentation with which to evaluate their impacts.

EXECUTIVE BUDGET ANALYSIS - SUMMARY

The lack of detail made a thorough analysis of many proposals very difficult, and in many cases in this analysis only questions could be raised since budget details were insufficient to reach conclusions and provide options.

REVENUE PROPOSALS

The Executive Budget contains six proposals which affect state revenue during the 1997 biennium. In total, the six proposals reduce revenue by \$20.2 million in fiscal 1996 and increase revenue by \$4.1 million in fiscal 1997, for a net reduction of \$16.1 million during the 1997 biennium.

The fiscal impact of these proposals on the state general fund and the school equalization account (SEA) are shown in Table 1. For a detailed discussion of executive tax policy initiatives, see page Tax Policy 1 in this volume.

Table 1
Executive Budget
Summary of General Fund/SEA Revenue Proposals
Figures in Millions

	Fiscal 1996	Fiscal 1997	Biennium
Individual Income Tax Refund	(\$25.000)	\$0.000	(\$25.000)
Permanent Coal Tax Trust			
Job Investment Act (Mezzanine Financing)	(0.039)	(0.075)	(0.114)
Microbusiness Financing Act	(0.024)	(0.057)	(0.081)
University System R&D Grants	(0.312)	(0.817)	(1.129)
Oil & Gas Taxation Reform (Project 95)	0.000	5.000	5.000
Coal Severance Tax Reallocation	5.200	0.000	5.200
 Total Revenue Proposal	 (\$20.175)	 \$4.051	 (\$16.124)

EXPENDITURE PROPOSALS

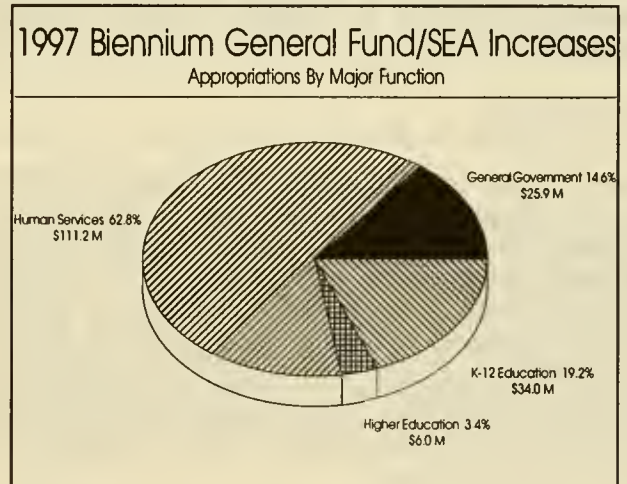
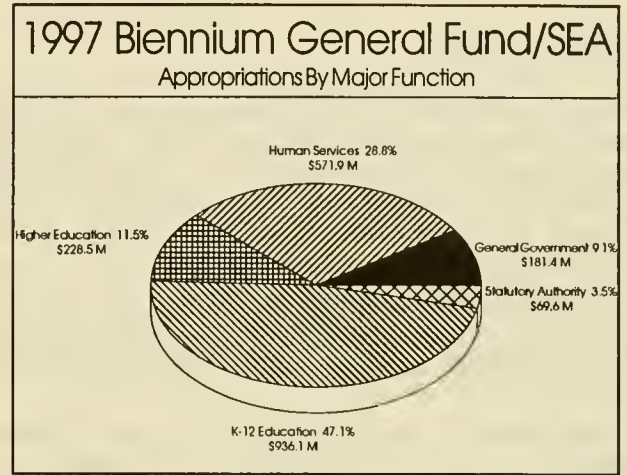
The following narrative discusses the Executive Budget from three perspectives: 1) fund type; 2) function/agency; and 3) expenditure type. The discussion and comparisons do not include initiatives such as the pay plan or the guaranteed annual retiree benefit adjustment. These initiatives are discussed in separate sections of this publication.

Expenditures by Fund Type

General Fund/SEA

In the 1995 biennium appropriation, human services total less than 26 percent and education over 61 percent of total general fund and SEA expenditures. Graphs 1 and 2 illustrate 1997 biennium general fund and school equalization account (SEA) expenditures. Graph 2 shows that the five agencies responsible for the provision of human services [the departments of Social and Rehabilitation Services (SRS), Family Services (DFS), Corrections and Human Services (DCHS), Health and Environmental Sciences (DHES), and Labor and Industry (DOLI)] account for over 62.8 percent of total increases in the Executive Budget. As a result, the relative share of total general fund and SEA expenditures for human services functions has increased from 26 to almost 29 percent over the biennium. In contrast, higher education and K-12 receive 22.6 percent of total increases. Consequently, even though the executive provides enrollment increases, education's relative share of total general fund is reduced to less than 59 percent.

Major human services expansions take place in benefits such as medicaid, developmental disabilities services, additional services to underserved youth, and corrections. These expansions are discussed in more detail at the conclusion of this discussion and in the program narratives in the "Agency Budget Analysis" section. SEA and enrollment increases are discussed in more detail beginning on page Overview 51.



EXPENDITURE PROPOSALS

Federal Funds

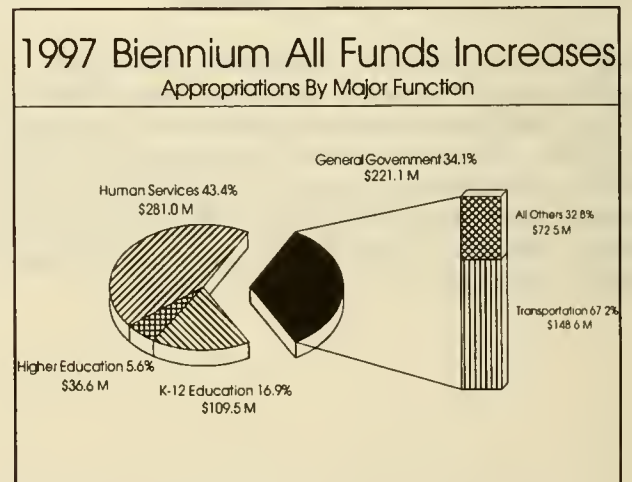
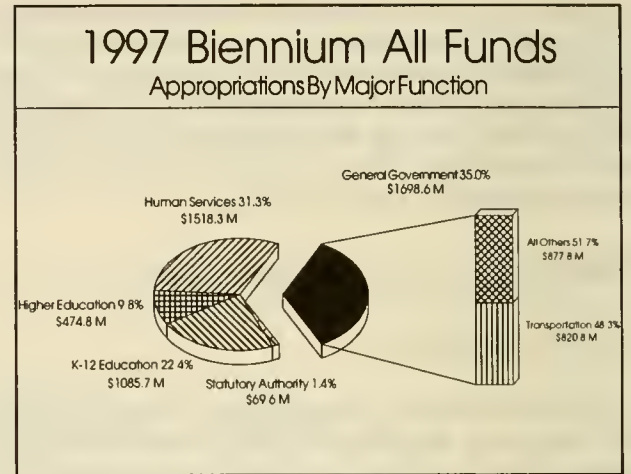
Federal funds directly appropriated to state agencies show an increase, unadjusted for continuing appropriations, of \$374.3 million, or 28 percent. The following factors account for almost 85 percent of the increase:

- 1) a change in accounting for and an increase in federal pass-through grants in the Office of Public Instruction (OPI), which adds over \$100 million;
- 2) increases in environmental and public health programs in the Department of Health and Environmental Sciences (DHES);
- 3) an increase in federal highways funds in Montana Department of Transportation (MDT); and
- 4) an increase in benefits in SRS and DFS.

In some instances, the increase in federal funds requires an increase in state matching funds. A more detailed description is included in the individual agency narratives in the "Agency Budget Analysis" section.

Total Funds

Graph 3 shows the allocation by major function in the Executive Budget of total funds, while Graph 4 shows the total funds increase. The graphs show that human services accounts for over 43 percent of the increase and that education requires almost 23 percent. At the same time, general government increases as a percent of total funds as a result of the increases to MDT for highways construction. The increases in total fund expenditures are described in the next section by agency within function.



EXPENDITURE PROPOSALS

Expenditures by Function/Agency

The following narrative discusses major increases (general fund and total funds) included in the Executive Budget for human services, as well as an explanation of major Montana Department of Transportation (MDT) and Montana University System (MUS) initiatives. K-12 education is discussed in a separate section.

Human Services

Social and Rehabilitation Services

The SRS budget increases the most of any state agency -- \$179.2 million total funds and \$50.9 million general fund between the 1995 biennium and the executive request for the 1997 biennium. SRS also has the second highest increase in federal funds with \$119.8 million. Changes in the SRS budget alone account for 29 percent of the total state budget increase and 34 percent of the statewide general fund increase.

The most significant component of the SRS increase is due to changes in benefits costs, which total \$161.3 million between the biennia or 90 percent of the total SRS increase and 26 percent of the total statewide increase. The general fund cost of SRS benefits increases \$37.6 million, which is 74 percent of the total SRS general fund increase and 25 percent of the total statewide general fund increase.

Medicaid benefits contribute the most growth in the SRS budget, increasing by \$129.6 million total funds. The general fund share of Medicaid benefits increases \$25.9 million between bienniums.

Present law adjustments for medical inflation, caseload growth, and utilization increases in primary care benefits (hospitals, doctors, drugs) show the most significant change, increasing \$65 million total funds. Primary care increases are offset by anticipated savings of over \$3 million general fund due to SRS initiating contracts for mental and physical health managed care.

The second most significant benefit change is developmental disabilities (DD) benefits, which

increase \$18.9 million between the biennia. Most of the DD benefit increase can be attributed to three present law adjustments and three new proposals. The present law adjustments are: 1) the fourth phase of downsizing Montana Development Center, which provides community services for 18 persons; 2) a 1.5 percent provider rate increase for the 1997 biennium; and 3) annualization of the 1995 biennium provider rate increase. The new proposals are: 1) development of community services for residents of Eastmont, which the executive proposes to close; 2) an increase in supported employment and supported living opportunities; and 3) an increase in federal Medicaid authority in case the executive can refinance general fund personal care group home costs. FTE and operating cost reductions for Eastmont and Montana Development Center in the Department of Corrections and Human Services budget offset the costs of community services increases.

Department of Family Services

The DFS budget increases \$25.6 million total funds (\$16.5 million general fund) from the 1995 biennium to the executive 1997 biennium request. DFS budget increases comprise 4 percent of total state increases and 11 percent of total statewide general fund increases.

Foster care caseload increases add \$2.1 million total funds and \$1.5 million general fund.

The most significant new proposal, Community Impact Grants, adds \$8.2 million general fund over the 1997 biennium. This proposal accounts for one half of the biennial general fund increase and about 5 percent of the total state budget general fund increase. The grants would be used to provide additional services to youth before they enter the juvenile justice system or foster care.

The second most significant change in the DFS budget is a present law adjustment and a new proposal to continue development and fund operation of the Child and Adult Protective Services (CAPS) computer system that add \$5.1 million total funds (\$2.1 million general fund) over the biennium. CAPS adjustments account for 20 percent of the total funds change in the DFS budget and 13 percent of the general fund change.

EXPENDITURE PROPOSALS

(Actual expenditures of about \$1 million for CAPS development were removed from the base.)

Other significant present law adjustments include: 1) general fund increases of \$1.7 million for expansion of therapeutic group homes; and 2) provider rate increases that add \$1.0 million total funds and \$0.6 million general fund. Other significant new proposals add: 1) 15 protective services workers, \$1.0 million total funds and \$0.6 million general fund; and 2) 1.0 FTE and \$0.2 million general fund to staff the Interdepartmental Coordinating Council established by SB 34 passed by the 1993 legislature.

DFS increases are partially offset by transfer of residential psychiatric treatment (RTC) to the Managing Resources Montana (MRM) program in the Department of Corrections and Human Services. The 1995 biennium RTC general fund base was \$4.7 million (including DFS, SRS, and Office of Public Instruction expenditures and appropriations) compared to \$9.6 million included in the 1997 biennium budget. Another new proposal to develop a wilderness camp for delinquent youth is presented in tandem with reductions at Mountain View School which eliminate 23.42 FTE and \$344,000 general fund over the biennium. The cost of the wilderness camp proposal is equal to the MVS cost reduction, since increases in state special revenue (parental contributions) and federal funds offset the general fund decrease.

Department of Corrections and Human Services

The executive increases the DCHS 1997 biennial budget by \$49,671,574 over the biennium. Of this increase, \$41,109,496, or 27.3 percent, is general fund. This increase is primarily attributable to increases to serve two populations: 1) expansion of the Managing Resources Montana (MRM) program for seriously emotionally disturbed youth; and 2) expansions in the Corrections Division to manage the escalating corrections population.

Services to Youth - The executive includes almost \$22 million in general fund grants to provide residential treatment and community mental health services to SED youth (the federal portion of the cost is included in the SRS budget).

Corrections - The executive also includes almost \$20 million in general fund to provide services to members of the correctional population, either directly or indirectly. Over \$11 million of this increase expands: 1) community corrections programs, including probation and parole officers, pre-release center beds and staff and beds at Swan River Correctional Training Center; 2) chemical dependency and sexual offender treatment services for inmates; and 3) regional jails for additional capacity. The executive also provides general fund for correctional officers, equipment and services within the institutions.

Department of Transportation

There are two primary reasons for the MDT budget increases: 1) increased state special revenue due to higher than anticipated collections; and 2) increased federal fund availability. (For further discussion of the revenue to highway special revenue account, reference the MDT narrative in the "Agency Budget Analysis" section.

The executive proposes increases primarily in highways construction -- almost \$100 million over the biennium. The other major increase is due to an accounting mechanism used to transfer funds from one account to another. The executive also increases the MDT budget for maintenance and construction supplies.

Higher Education

The executive proposal for the Montana University System includes \$221.5 million general fund and \$471.9 million total funds for the biennium. The Executive Budget is funded with 46.9 percent general fund and 31.5 percent tuition, compared to 50.4 percent and 26.2 percent respectively in the base year.

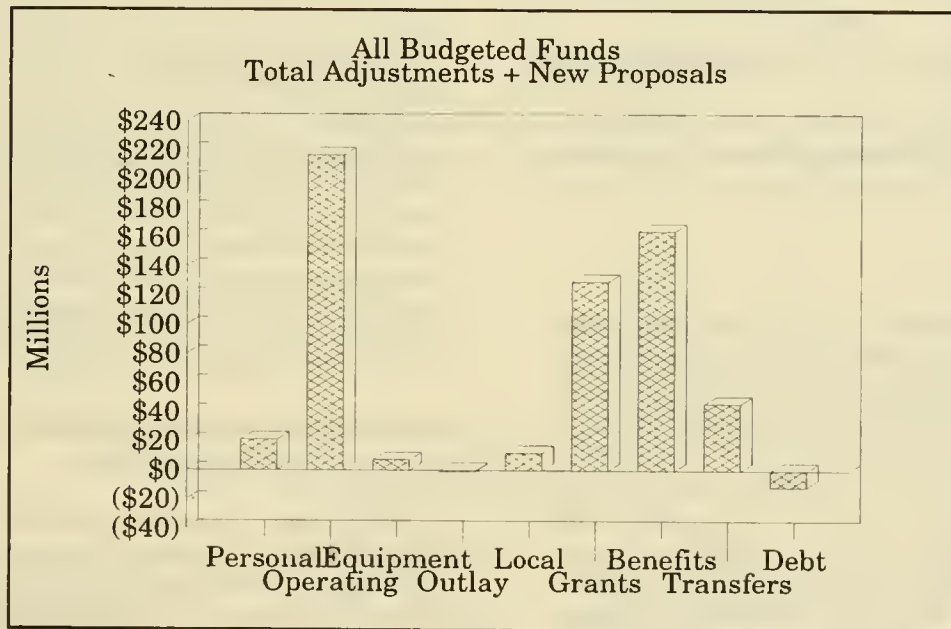
The Executive Budget present law adjustments are generally the result of: 1) annualization of the pay plan; 2) operation and maintenance for new buildings at the University of Montana and Montana State University; 3) inflationary and fixed costs adjustments; and 4) resident enrollment increases. Enrollment is anticipated to increase by over 1,500 students in the biennium when compared to the fiscal 1994 level. The executive adds \$8.4 million over the fiscal 1994 level to fund enrollment increases.

EXPENDITURE PROPOSALS

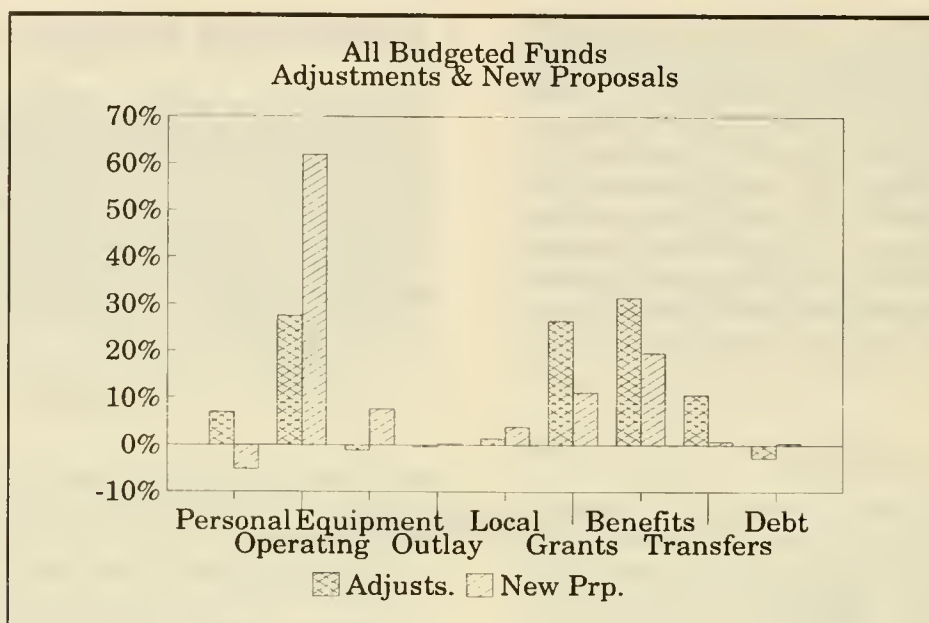
General fund is 14.6 percent of the total present law adjustment funding from fiscal 1994 expenditures, compared to 50.4 percent of the base funding. This shift is the direct result of increasing reliance on tuition as a funding source. This shift is continued in new proposals (totaling \$15.2 million over the biennium). General fund of \$1.3 million accounts for 8 percent of the funding. Tuition of \$14.2 million, which funds over 90 percent of the new proposals, is generated by non-resident enrollment management statewide and tuition increases at the University of Montana.

Expenditure by Type

The next two graphs illustrate the change in expenditures in the 1997 Executive Budget and percent growth rate by expenditure type. The graphs show that contracted services and grants and benefits experience the greatest increase. The increased priority of human services and highways construction and maintenance is evidenced by growth rates in these expenditure types.



EXPENDITURE PROPOSALS



While personal services show only a minimal increase, operating expenses increase by 26.3 percent in the 1997 biennium when compared to the 1995 biennium. The small increase in personal services and the large increase in operating expenses are not totally independent of one another. The executive has replaced some personal service reductions with contracted services, and has added contract authority to perform some duties for which state personnel may have been added in the past. While the personal services increase is only 3.0 percent, operating expenses and personal services together account for over 15 percent. Details follow.

Operating Expenses

Operating expenses increase by over \$216.7 million in the 1997 biennium when compared to the 1995 biennium, for an increase of 26.3 percent. With the exception of grants, which are skewed due to an accounting change, operating expenses show the greatest increase of any category of expenditure. Present law adjustments total over \$116.3 million, while new proposals measure an additional \$100.4 million. Some of the increase in contracted services is because the executive replaces state employees with

contracts. Therefore, the two categories should in some measure be examined in tandem.

Operating expenses will increase in a given year for a number of reasons, including:

- 1) fixed costs - agencies must pay certain costs for services performed by other agencies. Fixed costs total \$33.5 million in the 1997 biennium, compared to \$27.7 million appropriated in the 1995 biennium;
- 2) inflation - which totals approximately \$10.1 million in the 1997 biennium; and
- 3) appropriation of certain contingency funds - which includes several contingency appropriations, primarily in environmental programs.

However, almost all of the operating expense increase in the Executive Budget is due to other factors. Several of the major changes are highlighted below.

Montana Department of Transportation

Contractor payments for highways construction and maintenance are budgeted in contracted services.

EXPENDITURE PROPOSALS

Therefore, operating expenses reflect the Executive Budget emphasis on this activity. The Executive Budget includes additional operating expenses in MDT of over \$100 million over the biennium, accounting for the major increase in this category. Revenues are higher than anticipated by the 1993 legislature. The executive proposes expenditures of almost all of this increase in revenues for increased highway construction, including approximately \$75 million of state and federal matching funds and \$25 million for the state funded Reconstruction Trust Fund.

Other Increases in Operating Expenses

The majority of the remainder of increases in operating expenses are in other contracted services. These increases total over 10 percent of fiscal 1994 operating budgets. While widespread across agency budgets, the major increases take place in human services, as listed below. In all of these cases, the executive is replacing current state employees with contracted services. None of these changes result in significant general fund savings. Consequently, operating expenses reflect the executive emphasis on human services initiatives:

- 1) privatization of the remaining state pre-release centers;
- 2) welfare reform;
- 3) the Wilderness Camp proposal in the Department of Family Services;
- 4) centralization of laundry facilities at several state institutions; and
- 5) increased community services for former residents of the Montana Developmental Center and Eastmont Human Services Center.

Offset Personal Services Reductions

In some instances, operating expenses are increased to offset reductions in personal services included in new proposals. The major changes are shown in Table 1.

Table 1
Personal Services Reduction Replaced with Operating Expenses
1997 Biennium Executive Budget

Agency	Adjustment	--- New Proposal FTE Reduction ---			-- Present Law Increases --		-- Net Increase (Reduction)--	
		Fiscal 1997 FTE	General Fund	Other Fund	General Fund	Other Fund	General Fund	Other Fund
DCHS	Radiological Technician	-2.00	(\$124,709)	\$0	\$31,248	\$0	(\$93,461)	\$0
DCHS	MSP Laundry Program	-18.00	(846,545)	0	1,039,132	0	192,587	0
DCHS	Program Evaluator	-1.00	0	(50,709)	0	28,800	0	(21,909)
DCHS	Privatize Pre-Release Centers	-18.50	(974,849)	0	1,698,009	0	723,160	0
DCHS*	Downsize MDC	-17.30	(559,090)	0	635,512	959,440	76,422	959,440
DFS	Wilderness Camp	-23.40	(1,594,087)	0	1,250,087	344,000	(344,000)	344,000
DNRC	Energy Use Inspectors	-1.00	0	(65,822)	0	65,822	0	0
DNRC	UIC Inspector	-3.00	0	(148,467)	0	225,000	0	76,533
Labor & Industry	Legal Services	-0.35	0	(13,228)	0	15,000	0	1,772
Livestock	Eliminate Helicopter Pilot	-1.00	0	(73,605)	0	108,000	0	34,395
Revenue	Corporate Tax	-0.25	0	(19,370)	0	20,000	0	630
State Auditor	Actuary	-1.00	(109,860)	(54,094)	0	20,000	(109,860)	(34,094)
Transportation	Privatize Data Entry	-2.00	0	(70,000)	0	40,000	0	(30,000)
Totals		-88.80	(\$4,209,140)	(\$495,295)	\$4,653,988	\$1,826,062	\$444,848	\$1,330,767

*\$135,500 in operations also reduced

Contracts in Lieu of FTE

Among the operating increases are several where the executive appears to be adding contracted services in lieu of FTE, including over \$3.0 million in SRS. In addition to determining whether services should be

funded, the legislature may wish to examine the types of services that will be purchased through expansions in consulting and contracted services, if that expansion is authorized in lieu of adding FTE.

EXPENDITURE PROPOSALS

There are issues involved when consultants or contracted services are substituted for employees. Unless agencies have clearly identified functions that can be contracted, the Internal Revenue Service could later determine that contractors are in fact state employees. The state is liable for the employer's share of income taxes, unemployment insurance, worker's compensation, overtime. The state could potentially be liable for health and medical costs and retirement benefits that would have been covered by the state plans.

According to recent court decisions and federal and state law, independent contractors must have an arm's length agreement and be subject to little or no direct control by the employer in order to maintain their independent contractor status. Several work arrangements that could clearly violate independent contractor status include: 1) contractors who work "alongside" state employees; 2) state provision of equipment, office space, supplies, and materials for independent contractors; 3) set work times that the contractor must be present in a state office; and 4) direct supervision of a contract employee by a state employee. The legislature may wish to ascertain that budget increases for consulting or contracted services are truly independent consultants or contractors so that the state will not later be liable for employer's costs for FTE.

Personal Services

Personal services, including salaries, benefits, per diem, and other additions such as overtime, is the single largest expenditure for most state agencies. Personal services budgets comprise over 43 percent of total budgets (excluding grants and benefits) in the 1997 biennium Executive Budget, and about 23 percent of total state expenditures.

Total present law personal services increase over the 1995 biennium by \$29.3 million, or 4.2 percent. Personal services are reduced by a net total of \$8.4 million over the biennium in new proposals. (New proposals added by the executive to fund the proposed pay plan are discussed in more detail in the "Executive Pay Plan" narrative, page Overview 43.) If new proposals are taken into account, personal services increase by 3.0 percent.

There are a number of reasons for this net present law increase, including: 1) number of FTE; 2) pay plan annualization; 3) upgrades/downgrades; 4) full funding of vacancy savings; and 5) early retirement costs.

Number of FTE

A major factor in the minimal growth in present law personal services budgets is the lack of increase in FTE, which is primarily due to two offsetting factors: 1) an increase of 322.23 in fiscal 1996 and 268.96 in fiscal 1997 in executive new proposals; and 2) a decrease of 286.03 in fiscal 1996 and 294.03 in fiscal 1997 in new proposals to fund the executive's proposed pay plan. FTE growth may also have been slowed due to the increase in contracted services, if those increases were made in lieu of FTE additions. Table 2 compares the total number of FTE, by agency in fiscal 1994 and fiscal 1995, to the present law executive budget in the 1997 biennium. The table does not include any FTE added via budget amendment or legislative contract authority in fiscal 1994. As shown, there is no change from the appropriated fiscal 1995 level to fiscal 1997.

EXPENDITURE PROPOSALS

Table 2
Total FTE Comparison*
HB 2 to Executive Budget
1995 Biennium to 1997 Biennium

Agency	HB 2 Fiscal 1994**	HB 2 Fiscal 1995**	Executive Budget Fiscal 1996	Executive Budget Fiscal 1997	Increase (Decrease) 1995-97
Legislative Auditor	63.50	63.50	63.50	63.50	0.00
Legislative Fiscal Analyst	16.80	16.80	16.80	16.80	0.00
Legislative Council	42.97	48.14	44.97	50.14	2.00
Environmental Quality Council	6.50	6.50	6.50	6.50	0.00
Consumer Counsel	5.25	5.25	5.25	5.25	0.00
Governor's Office	49.25	49.25	48.00	48.00	(1.25)
Secretary of State	34.30	34.30	44.80	44.80	10.50
Comm of Political Practices	3.25	3.25	3.25	3.25	0.00
State Auditor	72.75	73.00	74.75	75.00	2.00
Transportation	1,933.75	1,933.75	1,898.40	1,899.40	(34.35)
Revenue	669.39	614.89	648.39	648.39	33.50
Administration	311.51	315.76	313.44	317.44	1.68
Public Employees' Retirement System	22.00	21.00	19.50	19.50	(1.50)
Teachers' Retirement System	11.50	11.50	11.00	11.00	(0.50)
General Government and Transportation	3,242.72	3,196.89	3,198.55	3,208.97	12.08
Labor and Industry	659.00	659.00	636.00	636.00	(23.00)
Social and Rehabilitation Services	944.45	988.45	975.95	975.95	(12.50)
Family Services	607.18	574.93	565.76	570.76	(4.17)
Health and Environmental Sciences	451.04	456.09	501.59	508.09	52.00
Human Services	2,661.67	2,678.47	2,679.30	2,690.80	12.33
Public Service Regulation	44.50	44.50	44.50	44.50	0.00
Fish, Wildlife and Parks	554.95	553.37	544.46	545.21	(8.16)
State Lands	356.27	356.36	352.36	352.36	(4.00)
Livestock	122.71	123.71	120.71	120.71	(3.00)
Natural Resources and Conservation	240.42	237.42	228.50	228.50	(8.92)
Agriculture	107.16	105.83	101.16	101.16	(4.67)
Commerce	335.69	335.03	331.81	331.81	(3.22)
Natural Resources and Commerce	1,761.70	1,756.22	1,723.50	1,724.25	(31.97)
Judiciary	89.25	89.25	91.25	91.25	2.00
Crime Control Division	19.00	19.00	21.00	21.00	2.00
Highway Traffic Safety	8.50	8.50	8.50	8.50	0.00
Justice	656.70	652.55	672.55	672.55	20.00
Arts Council	9.97	9.97	11.00	11.00	1.03
State Library	28.50	28.50	28.50	28.50	0.00
Historical Society	48.38	48.13	50.63	50.63	2.50
Corrections and Human Services	1,882.05	1,872.05	1,939.50	1,865.98	(6.07)
Military Affairs	98.94	97.65	97.40	97.40	(0.25)
Institutions and Public Safety	2,841.29	2,825.60	2,920.33	2,846.81	21.21
Office of Public Instruction	134.73	134.73	138.23	135.23	0.50
Board of Public Education	4.00	4.00	4.00	4.00	0.00
School for the Deaf and Blind	81.68	81.68	79.27	79.27	(2.41)
Council for Vo-Ed	2.50	2.50	2.50	2.50	0.00
Commissioner of Higher Ed	84.95	87.95	76.2	76.2	(11.75)
Education	307.86	310.86	300.20	297.20	(13.66)
Total FTE	10,815	10,768	10,822	10,768	(0.01)

*Does not include the University System with the exception of the Office of the Commissioner of Higher Education.

**After the November 1993 Special Session.

EXPENDITURE PROPOSALS

Pay Plan Annualization

The 1993 legislature passed HB 198, which provides two increases to state employee compensation:

- 1) 1.5 percent pay increase, beginning in the first full pay period of calendar 1995; and
- 2) a \$20 per month increase in fiscal 1994 and a further \$20 per month increase in fiscal 1995 for health insurance.

Because the provisions of the pay plan were not fully implemented in fiscal 1994, personal services costs increase in the 1997 biennium. Fiscal 1994 budgeted pay plan costs totaled \$3.5 million. Anticipated costs in the 1997 biennium total over \$12 million each year.

Upgrades/Downgrades

The Executive Budget includes funding for a net 891 upgrades awarded by the Department of Administration (DofA) in fiscal 1994. DofA is required to "continuously review all positions on a regular basis and adjust classifications to reflect significant changes in duties and responsibilities." Review of classification of positions can occur in several ways, including:

1) agency management initiated actions, whereby an agency may request that DofA reclassify a position to more accurately reflect its current duties, or to review in response to employee requests. Over 80 percent of reclassifications are initiated by agencies.

2) DofA initiated actions, whereby DofA reviews a classification as part of its responsibility to "continuously review" all positions. Over 10 percent of upgrades result from this type of review.

3) employee appeals, in which an employee initiates a review through the filing of an appeal.

Table 3 shows by agency, the number of upgrades/downgrades approved by DofA in fiscal 1994. As shown in the table, with the exception of the Vocational Education Council, the Department of Family Services received the greatest percent increase -- 21.8 percent. Only two agencies received net downgrades.

EXPENDITURE PROPOSALS

Table 3
Upgrades/Downgrades Approved
July 1, 1993 through July 22, 1994

Agency	FTE*	Upgrades	Downgrades	Net Upgrades	Percent of Total
Governor's Office	50.25	1.00	0.00	1.00	2.0%
Fish, Wildlife, Parks	601.24	97.00	8.00	89.00	14.8%
Health and Env. Sci.	457.83	20.00	24.00	(4.00)	-0.9%
Transportation	1,934.35	67.00	30.00	37.00	1.9%
State Lands	360.27	45.00	7.00	38.00	10.5%
Livestock	122.71	0.00	3.00	(3.00)	-2.4%
DNRC	246.92	26.00	11.00	15.00	6.1%
Revenue	782.14	115.00	42.00	73.00	9.3%
Administration	314.26	50.00	17.00	33.00	10.5%
Agriculture	109.21	17.00	4.00	13.00	11.9%
Corrections and HS	1,899.57	281.00	34.00	247.00	13.0%
Commerce	338.32	22.00	18.00	4.00	1.2%
Labor and Industry	709.26	55.00	13.00	42.00	5.9%
Military Affairs	99.56	4.00	3.00	1.00	1.0%
SRS	947.70	196.00	62.00	134.00	14.1%
Family Services	611.42	154.00	21.00	133.00	21.8%
State Auditor	74.75	9.00	4.00	5.00	6.7%
OPI	139.23	10.00	3.00	7.00	5.0%
Justice	667.45	47.00	30.00	17.00	2.5%
PSC	44.50	4.00	2.00	2.00	4.5%
Arts Council	10.08	1.00	0.00	1.00	9.9%
State Library	36.52	1.00	1.00	0.00	0.0%
VoEd Adv Council	2.50	1.00	0.00	1.00	40.0%
Historical Society	55.52	5.00	0.00	5.00	9.0%
Total	10,615.56	1,228.00	337.00	891.00	8.4%

*From June 30, 1994 PPP report.

If DofA approves a reclassification, the agency must pay the adjusted salary. The executive present law includes all upgrades through June 1994. Funding for

any subsequent upgrades must be specifically requested from the legislature.

EXPENDITURE PROPOSALS

Full Funding of Fiscal 1994 Vacancy Savings

A number of factors can influence the level of vacancy savings an agency will experience. In fiscal 1994, the two most influential factors had offsetting impacts on the level of actual vacancy savings realized.

1) Agencies were not given additional money to fund early retirement payout costs, and had to fund these costs from existing appropriations. Therefore, some vacancy savings that may have accrued was used to fund these costs; and

2) Most agency budgets were reduced by a vacancy savings rate imposed by the 1993 legislature for an amount equivalent to 5 percent of total personal services.

The 1993 legislature appropriated contingency funds totaling \$1.9 million (\$0.5 million general fund) in fiscal 1994 and \$1.8 million (\$0.5 million general fund) in fiscal 1995, partially offsetting the impact of vacancy savings. The amounts were equivalent to 10 percent of total general funded personal services and 20 percent of total other funds personal services. The contingency appropriation was made to the Department of Administration for distribution by the Office of Budget and Program Planning (OBPP) to agencies that experienced actual personal services costs in excess of budgeted personal services. Agencies requested a total of over \$3.6 million from the contingency funds.

The executive fully funds all positions in present law. Vacancy savings is included in new proposals for the purpose of funding the proposed executive pay plan. For a further discussion, see the "Executive Pay Plan" narrative, page Overview 43.

Early Retirement Costs

Offsetting the impact of the previous factors is the early retirement incentive. The 1993 legislature passed HB 517, which among other features provided an early retirement incentive for members of the Public Employees' Retirement System (PERS) and university system members of the Teachers' Retirement System (TRS). (Non-university system TRS employers could voluntarily participate.) As a result of this incentive, agencies incurred a number of costs in fiscal 1994 that could not be carried forward into the 1997 biennium. In addition to actual incentive costs, agencies also incurred additional termination payouts. Table 4 shows total incentive payments made and still owed by agencies in fiscal 1994, as reported by PERS and the MUS.

EXPENDITURE PROPOSALS

Table 4
Retirement Incentive Payments
Fiscal 1994 and Deferred

AGENCY	PERS Paid	TRS Paid	Balance Due*	Deferred TRS	Total Obligation
Legislative Auditor	\$0				\$0
Legislative Fiscal Analyst	19,388				19,388
Legislative Council	30,181				30,181
Senate	3,976				3,976
House	22,290				22,290
Environmental Quality Council					0
Consumer Counsel					0
Governor's Office	21,830				21,830
Secretary of State	18,885				18,885
Comm of Political Practices					0
State Auditor					0
Transportation	2,768,040				2,768,040
Revenue	94,152		225,462		319,614
Administration	196,216				196,216
State Fund	81,815				81,815
PERS	15,475				15,475
TRS					
General Govt and Transportation	\$3,272,248	\$0	\$225,462	\$0	\$3,497,710
Labor and Industry	\$323,996		\$104,675		\$428,671
SRS	440,816		144,195		585,011
DFS	51,681		465,131		516,812
DHES	197,993				197,993
Human Services	\$1,014,486	\$0	\$714,001	\$0	\$1,728,487
Public Service Regulation	\$39,586				\$39,586
Fish, Wildlife and Parks	345,121		7,162		352,283
State Lands	111,509				111,509
Livestock	194,790				194,790
DNRC	76,917				76,917
Agriculture	34,185				34,185
Commerce	175,515		91,903		267,418
Natural Resources and Commerce	\$977,623	\$0	\$99,065	\$0	\$1,076,688
Judiciary	\$1,225		\$11,027		\$12,252
Crime Control Division					0
Highway Traffic Safety					0
Justice	158,142		34,564		192,706
Arts Council					0
State Library	25,867				25,867
Historical Society	22,000				22,000
Corrections and Human Services	652,805				652,805
Military Affairs	33,967				33,967
Institutions and Public Safety	\$894,006	\$0	\$45,591	\$0	\$939,597
OPI	\$32,344		\$79,480		\$111,824
Board of Public Education					0
School for the Deaf and Blind	31,989				31,989
Council for Vo-Ed					0
Commissioner of Higher Education	11,269		8,412		19,681
Colleges of Technology	5,461	418,852		28,360	452,673
Six Units	574,979	1,507,943	153,589	327,247	2,563,758
Ag Experiment Station					0
Cooperative Extension Service					0
Forest and Conservation Exp Station					0
Bureau of Mines					0
Fire Services Training School					0
Education	\$656,042	\$1,926,795	\$241,481	\$355,607	\$3,179,925
Total State Government	\$6,814,405	\$1,926,795	\$1,325,600	\$355,607	\$10,422,407

*Includes interest payments due.

EXPENDITURE PROPOSALS

Table 5 shows changes in selected termination costs between fiscal 1993 and fiscal 1994. As shown, these costs increased significantly.

Table 5
Selected Termination Costs
Fiscal 1991 to Fiscal 1994

Year	Severance Payout RIF	Termination Sick-Leave	Termination Vacation
Fiscal 1991	\$0	\$1,335,325	\$1,922,913
Fiscal 1992	0	1,427,121	2,026,721
Fiscal 1993	44,010	1,693,697	2,556,274
Fiscal 1994	113,375	3,435,989	4,483,940

Offsetting these costs are the impacts of hiring replacement FTE at lower salaries than the retiree, or not refilling positions. While preliminary data is not yet available to gauge the impact of this incentive for all agencies, PERS must submit a report on the impacts of the early retirement incentive to the 1995 legislature. (The MUS submitted a report on impacts in December. This report will be analyzed with the PERS report.)

Benefits and Grants

Benefits in the Executive Budget increase by 18.0 percent and grants by almost 60.0 percent over the 1995 biennium levels. Increases in benefits are primarily in human services programs, and are discussed in that context above. Increases in grants are due to the following:

- 1) the change in accounting for OPI federal pass-through grants, which accounts for almost 40 percent of the total increase;
- 2) other federal grants in OPI distributed to school districts;
- 3) federal Housing and Urban Development Section Eight grants, Community Development Block grants, and Home Investment Partnership grants at Department of Commerce;
- 4) general fund to provide treatment services to seriously emotionally disturbed youth through the Managing Resources Montana (MRM) program at DCHS; and
- 5) general fund for community impact grants in a new program for troubled youth at DFS.

FUND BALANCE

It is clear that the state's financial position is much brighter than that of recent bienniums. Income tax revenue for fiscal 1994 exceeded projections by \$17.3 million and moderate growth is predicted for most of the state's revenue sources in fiscal 1995 through 1997. As discussed under "State Fiscal Outlook" the executive projects a general fund ending balance of \$55.7 million in fiscal 1995, \$22.0 million in 1996, and \$25.3 million in 1997. Prudent financial management of state disbursements, coupled with stable or growing revenue collections, are key factors in achieving structural balance. An additional component essential to achieving a sound financial foundation, however, is the ability to meet unanticipated disbursements needs and address revenue shortfalls.

Several factors should be considered when analyzing a state's fiscal health. For example, anticipated disbursement and revenue growth, as well as the volatility associated with disbursements and revenue sources, should be taken into consideration. Rating agencies, such as Moody's Investors Service (Moody's), also consider a state's history of achieving budget targets and the ability to address unforeseen budget deficits as key variables in assigning ratings to state debt. Moreover, Moody's uses the general fund balance as a percent of revenues as one of the key financial indicators used in credit analysis. According to the National Conference of State Legislatures (NCSL), "the general fund year-end balance as a percentage of the state's general fund budget is the measure most commonly used to assess state fiscal conditions because it allows meaningful comparisons between states".

The main controversy regarding fund balance reserves is determining the appropriate percentage to be used as a measure of sound financial management, with experts suggesting between 2.5 to 5.0 percent of annual revenues. The NCSL reports that financial analysts recommend a reserve in the range of 3 to 5 percent. Moody's suggests that, as a general rule of thumb, a general fund balance equal to at least 5 percent of revenues is preferred.

The Executive Budget projects a general fund ending fund balance (Table 1) of between 3.4 and 3.6 percent of annual revenues for fiscal 1996 through 1997, (see "Governor's Executive Budget: Fiscal Years 1996-1997", pages Summary 2 through Summary 6). Moreover, the executive revenue estimates include \$15.3 million in litigated rail car taxes not considered in the revenue assumptions and corresponding estimates adopted by the Revenue Oversight Committee (see "Revenue" section, Volume 1 of the 1997 Biennium Budget Analysis).

FUND BALANCE

Table 1
Executive Budget
Fund Balance as Percent of Revenue
(In Millions)

	Estimated FY 1996	Estimated FY 1997	Estimated 1997 Biennium
General Fund Revenue	\$644.3	\$703.7	\$1,348.0
School Equalization Account Revenue	<u>291.8</u>	<u>303.8</u>	<u>595.6</u>
Total	<u>\$936.1</u>	<u>\$1,007.5</u>	<u>\$1,943.6</u>
Executive Fund Balance	\$22.0	\$25.3	\$25.3
Balance as a % of GF Revenue	3.4	3.6	1.9
Balance as a % of GF/SEA Revenue	2.4	2.5	1.3

In determining the ending fund balance necessary to help achieve financial soundness, the legislature should consider the additional budgetary factors discussed above, including: volatility of revenue collections, unexpected growth in disbursements, and other emergencies. For example, unanticipated growth in entitlement program costs to the general fund could occur due to increased demand or reduced federal funding. In any year, the state could be faced with fire suppressions costs comparable to the \$20.7 million expended in fiscal 1994. Costs associated with litigation or other judicial directives could also result in unbudgeted disbursement increases similar to what the state experienced in regard to public school funding. Moreover, revenue shortfalls in the school equalization account (SEA) are required by law to be supplemented with general fund dollars. Due to some of these uncertainties, a \$25 million ending fund balance may be insufficient.

Financial crises could be minimized and special sessions avoided if adequate general fund reserves were available to address fiscal emergencies. Currently, forty-four states have established a "rainy day fund" for meeting contingencies, and several have instituted disbursement control measures. Rhode Island, for example, limits disbursements to 98 percent of revenues, with the remaining 2 percent deposited into a budget stabilization fund. When the fund reaches 3 percent of disbursements, the excess amount is to be used for debt reduction, debt service, or capital projects.

The State of Montana has held three special sessions in the last two biennia to address budget shortfalls, which occurred for a variety of reasons. Placing excess revenue collections in a reserve fund would not necessarily pre-empt special sessions, but could be used for prudent financial management.

FISCAL 1995 SUPPLEMENTALS

The Executive Budget includes \$17.0 million, of which over \$16.4 million is general fund, in supplementals in fiscal 1995. The majority (\$12.7 million) of the request is for fire suppression costs in the Department of State Lands.

The following table lists each supplemental request and the funding source. Please note that the table does not include two general fund supplementals to which the executive has given preliminary approval: a) \$18,000 for unanticipated legal expenses; and b) \$43,429 for other CI 118 costs. Both additions would be to the Commissioner of Political Practices. These supplementals were not included pending official executive notification of approval. In addition, the Department of Justice has requested that a supplemental included in the Executive Budget be withdrawn -- \$12,000 of general fund to fund county attorney payroll costs.

This general fund supplemental request of over \$16.5 million is significantly reduced from the fiscal 1993 level of \$82.2 million, primarily because no funds are requested to supplement either human services programs or the school equalization program. Only \$4.2 million is for other than fire suppression costs. This reflects a requirement in HB 500 by the 1993 legislature that supplemental proposals include a plan for reducing expenditures in the second year of the biennium to contain expenditures within the total biennial appropriations, and a commitment by the Governor to avoid supplementals. In the 1993 biennium, a total of \$37.8 million was appropriated for human services programs and \$26.6 million for school equalization. Table 2 shows supplemental appropriations since the 1987 biennium.

Table 2
General Fund Supplementals
1987 to 1995 Biennia

Biennium	Millions
1987	\$32.7
1989	17.1
1991	20.4
1993	82.2
1995	16.5

The individual supplemental requests are discussed in more detail in the individual agency narratives in the Agency Budget Analysis section. The issue of appropriation transfers between the Department of Social and Rehabilitation Services (SRS) and the Department of Family Services (DFS) to avoid supplemental appropriations is also discussed in the narrative for DFS in the Agency Budget Analysis section.

FISCAL 1995 SUPPLEMENTALS

Table 1
Supplemental Appropriation Requests
Executive Budget
Fiscal 1995

Section/Agency/Purpose	General Fund	State Special	Proprietary	Total
General Government and Transportation				
Secretary of State				
Business and Governmental Services			\$92,000	\$92,000
Commissioner of Political Practices				
Initiative 118	\$54,900			54,900
Transportation				
McCarty Farms	586,375			586,375
Justice				
County Attorney Payroll	12,000			12,000
Total Section	\$653,275	\$0	\$92,000	\$745,275
Human Services - No Supplementals				
Natural Resources and Commerce				
State Lands				
Fire Suppression	12,700,000			12,700,000
Corrections, Cultural Ed, Public Safety				
Justice				
Highway Patrol		436,000		436,000
Legal Services	400,000			400,000
Cascade County	1,000,000			1,000,000
Total Section	1,400,000	436,000	0	1,836,000
Education				
Office of Public Instruction				
Transportation	1,720,000			1,720,000
Total All Sections	\$16,473,275	\$436,000	\$92,000	\$17,001,275

*OBPP states that the Cascade County and a portion of the fire suppression requests will be included in a separate supplemental bill due to severe cash flow issues.

EXECUTIVE PAY PLAN

The executive is proposing to spend over \$33 million over the biennium for pay plan adjustments. Of this total, \$16.2 million is general fund. The executive is also proposing a change in the way an individual employee's salary adjustment is determined.

Background

The majority of state employees' salaries are established using the general state matrix. Prior to fiscal 1992, the matrix consisted of two factors: 1) a grade level, based upon the duties, responsibilities, and required knowledge or skills in a particular position; and 2) a step level, designed to correlate to years of service.

The 1991 legislature abolished the step system in favor of a market-based, open-range plan for employees. This move was made to address problems identified by the State Employee Compensation Committee, which had been established by the 1989 legislature. After conducting a salary survey, the committee concluded that salaries for many mid- and top-level employees and entry salaries for some professional and technical fields were well below the levels paid by other public employers and in private industry in Montana. It also determined that the existing 13-step plan was too rigid and that freezing steps in recent years had resulted in significant pay compression (over 50 percent of all employees were at step 3 or lower).

Instead of steps based upon years of service, the market-based system consists of the following for each grade: 1) an entry level; and 2) a market level, defined as the market salary for that grade. Along with the abolishment of steps, the legislature provided a pay increase and required that a market survey be conducted each biennium to determine market salaries.

The 1993 legislature passed HB 198, the major salary provision of which was an increase of 1.5 percent in the first complete pay period of calendar 1995 (the last six months of the 1997 biennium). While a market survey was conducted in that year, no adjustments were made to the statutory market salary for each grade as a result.

Market Surveys

As stated, the Department of Administration (DofA) is required to conduct a market salary survey each biennium. Prior to the 1994 survey, the following states were used: Washington, Idaho, North Dakota, South Dakota, and Wyoming. The following table shows the results of the survey in each of the last three biennia.

EXECUTIVE PAY PLAN

Table 1
State Employee Actual Pay
Compared to Market Pay

Grade	1990 Survey	1992 Survey	**1994 Survey
5	87.0%	97.6%	91.4%
6	96.0	101.8	97.2
7	96.8	100.8	100.0
8	83.8	100.9	101.6
9	88.6	101.5	95.8
10	91.0	95.1	99.2
11	90.9	89.2	94.7
12	87.0	91.4	93.0
13	84.0	89.5	89.9
14	84.3	89.9	94.1
15	84.0	85.1	86.2
16	88.5	87.2	90.9
17	94.0	92.9	94.3
18	82.3	88.1	98.2
19	88.3	83.3	***
20	*95.1	86.3	***
21	*95.1	84.1	***
22	*95.1	88.6	***

* Average Grades 20-22

** Excludes Washington

*** Not included in survey results

Source: DofA 1990, 1992, and 1994 surveys

The table shows salaries for lower grade positions close to market salary since the 1992 survey (in large part reflecting the salary increases enacted by the 1991 legislature). While the 1994 survey shows that mid-level positions are not as close to market level, the table also shows a significant improvement in the market standing of the mid- and upper-grades from the 1992 to 1994 surveys. However, results in 1994 are not comparable to previous surveys. As stated, Washington is included in the 1990 and 1992 surveys. However, Washington is excluded from the 1994 survey. According to DofA, Washington salaries are comparable for the lower grades, but not comparable for the mid- and upper-level grades, and have skewed the results of past surveys. However, excluding Washington and rendering the surveys incomparable means that the legislature cannot know from the results of this survey whether Montana salaries are moving closer to or further from market salaries. In addition, Washington salaries are a major determinate of the ability of the state to fill technical and

professional positions, as Montana must compete with the Washington market in those fields.

Executive Proposal

The executive pay plan proposal consists of the creation of a market "grid" to determine salaries (explained below). The use of this grid also includes provision of progression increases. In addition, the executive proposes other measures to adjust salaries. Finally, the executive includes a reduction in insurance contributions. Issues with the manner in which the executive proposes to fund the pay plan are discussed separately from the pay plan proposal. As of the writing of this analysis, the pay plan proposal was being adjusted by the executive based upon union negotiations. This analysis is based upon the status of the negotiations and of the requested bill draft as of December 19, 1994. Updates to this analysis will be conducted as necessary based upon the final proposal.

The following discussion is divided into two parts: 1) changes resulting in salary adjustments, including the market grid; and 2) insurance contributions.

Changes Resulting in Salary Adjustments

Market Grid and Progression Increase

The two previous pay plans adopted by the legislature have generally provided uniform increases to state employee pay via two methods:

a) most employees received a \$1 per hour increase in the 1993 biennium. Consequently, lower grade employees (who were already closer to market salaries) received higher percentage increases than higher-grade employees.

b) in the 1995 biennium, employees received a 1.5 percent salary increase, beginning in calendar 1995.

In both instances, adjustments had little or no relation to where the employee's salary fell in relation to market salary. In general, the executive pay plan proposal is an attempt to incorporate market progression and apply it to individual employees. The executive proposes to implement a mechanism by

EXECUTIVE PAY PLAN

which individual employees receive a market progression salary adjustment by using a market grid.

The following table shows the components of the market grid proposed by the executive, using a sampling of grade levels. As shown in the grid, those positions at lower grade levels would require fewer years of service before 100 percent of market is reached. However, because these positions are currently closer to market, the highest increases would be provided to higher grade employees, who are furthest from market.

The horizontal line is the employee's years of service, while the vertical is the employee's grade. The individual numbers within the grid are a percent of market salary. The executive proposes to establish the employee's salary based upon grade and years of service to the percent of market salary at which an employee should be.

Table 2 Sample of Market Grid 1997 Biennium											
TARGET INCREMENTS											
Grade	Years 0	1	2	3	4	5	6	7	8	9	10
4	0.844	0.874	0.904	0.935	0.967	0.999	1.000	1.000	1.000	1.000	1.000
6	0.84	0.868	0.895	0.925	0.955	0.985	1.000	1.000	1.000	1.000	1.000
8	0.836	0.862	0.889	0.916	0.944	0.972	1.000	1.000	1.000	1.000	1.000
12	0.828	0.851	0.875	0.899	0.924	0.949	0.975	1.000	1.000	1.000	1.000
15	0.822	0.844	0.866	0.888	0.911	0.934	0.953	0.982	1.000	1.000	1.000
18	0.816	0.836	0.857	0.878	0.899	0.921	0.943	0.966	0.989	1.000	1.000
22	0.808	0.827	0.846	0.866	0.886	0.906	0.927	0.948	0.97	0.992	1.000

For example, a grade 15 employee with 5 years of service "should" be at 93.4 percent of the market rate, according to the grid. If the employee is not, they would receive an increase to either reach 93.4 percent or receive a capped maximum 5 percent increase, whichever is less. Under this plan, those employees furthest from market would receive the largest increases. Because professional and technical positions consistently show the furthest difference from market, those positions would receive the highest increase. Because lower-grade employees are currently closer to market, salary increases for these employees would generally be less. Table 3 illustrates this point and shows a hypothetical application of the grid.

Table 3 Example of Adjustment 5 Years of Service		
Factor	Grade 8	Grade 15
Market Salary	\$17,747	\$32,196
Target Market %	97.2	93.4
Target Salary	17,250	30,071
Actual Salary*	18,031	27,753
Increase	(781)	2,318
Actual Adjustment	0	1,388 **
*Based upon percent of market salary of 101.6 percent for grade 8 and 86.2 percent for grade 15 per 1994 survey results.		
**Due to cap of 5 percent		

EXECUTIVE PAY PLAN

Teachers at state institutions have unique pay matrices based upon years of service and educational level with increases given for each additional year of service. The executive proposes to increase the teachers' pay matrices by 2.5 percent on October 1, 1996, mirroring the general pay matrix proposal. For blue collar and retail clerks, the executive proposes a cents per hour increase.

Adjustment in Market

The executive includes an adjustment in total entry and market salaries on the pay scale. The executive would adjust the general pay matrix market salaries by 2.5 percent beginning in October, 1996 (fiscal 1997). Therefore, not only would an employee receive a progression increase, the market level used as a target would increase. In addition, no employee would lose market share. For example, if an employee was at 100 percent of market, and at 98.5 percent after the adjustment, the employer would remain at 100 percent. The impact of this maintenance is that all employees will receive at least a 2.5 percent increase in fiscal 1997. In fiscal 1997, the salary cap would be raised to 6 percent. The following table illustrates the impact for the employees shown in the previous table.

Table 4
Increase in Market Salary

Component	Grade 8	Grade 15**
--- Fiscal 1996 ---		
Market Salary	\$17,747	\$32,196
Years of Service	5	5
Current Salary*	18,031	27,753
Percent of Market	101.6	86.2
Final Salary	18,031	29,141
% Increase	0	5.0%
--- Fiscal 1997 ---		
Market Salary (2.5%)	\$18,191	\$33,001
Years of Service	6	6
Target % of Market	100.0%	95.8%
Employee Previous Market %	101.6	86.2
Final Salary	18,482	30,889
% Increase from Fiscal 1996	2.5%	6.0%

*Based upon percent of market salary of 101.6 percent for grade 8 and 86.2 percent for grade 15 per 1994 survey results.

**In both years, grade 15 salary increases would be capped. Without the cap, salary increases would total 8.4 percent in fiscal 1996 and 7.5 percent in fiscal 1997.

EXECUTIVE PAY PLAN

The following table shows the current general pay matrix (fiscal 1996), and as proposed by the executive for most of fiscal 1997.

Table 5
General Pay Matrix

Grade	-- Fiscal 1996 --		-- Fiscal 1997 --	
	Entry	Market	Entry	Market
1	\$8,679	\$10,210	\$8,897	\$10,466
2	9,349	11,025	9,583	11,300
3	10,070	11,903	10,321	12,201
4	10,852	12,858	11,123	13,180
5	11,727	13,927	12,020	14,276
6	12,672	15,086	12,988	15,463
7	13,688	16,334	14,031	16,743
8	14,836	17,747	15,208	18,190
9	16,064	19,262	16,465	19,744
10	17,424	20,942	17,860	21,465
11	18,904	22,775	19,376	23,345
12	20,545	24,812	21,058	25,433
13	22,325	27,027	22,883	27,703
14	24,295	29,485	24,902	30,221
15	26,465	32,196	27,128	33,001
16	28,885	35,226	29,607	36,108
17	31,585	38,613	32,374	39,578
18	34,562	42,355	35,425	43,414
19	37,897	46,557	38,845	47,721
20	41,618	51,254	42,659	52,535
21	45,754	56,487	46,898	57,899
22	50,373	62,343	51,633	63,902
23	55,584	68,963	56,973	70,686
24	61,434	76,410	62,971	78,321
25	67,907	84,673	69,606	86,789

Longevity Increase

The executive proposes to increase the longevity payment. Longevity is an adjustment to salaries based upon a specified length of service. Currently, employees receive an additional 0.9 percent of base salary multiplied by the number of completed, contiguous 5-year periods of uninterrupted state service (or \$10 per month, whichever is greater). The executive proposes 1.5 percent of base salary for each complete, contiguous 5 years of uninterrupted service beginning on September 30, 1995 (fiscal 1996). Estimated cost of this change is up to \$4.0 million over the biennium. Annual costs beginning in fiscal 1997 are approximately \$2.4 million each year.

Insurance Contribution

The state currently contributes \$230 per month for health and other insurance per employee. The executive is proposing that the insurance contribution be reduced to \$225 per month. The net impact of this change would be a reduction of about \$1.3 million over the biennium, of which approximately \$0.6 million is general fund. Because this adjustment was made just prior to publication of the analysis, an analysis of issues associated with this adjustment is not included.

Issues

Two issues are raised with this proposal:

1) the executive includes total funding of \$33.1 million over the biennium. However, on-going costs will be significantly different. The progression increases are scheduled to begin in the first pay period in fiscal 1996 in which October 2 falls, for most employees. In fiscal 1997, the market adjustment would be made during the same time period. Because this date is 3 months into the fiscal year, the full year costs of the pay plan are not represented in the appropriation in the executive budget. Actual yearly costs after full implementation would be 25 percent higher than the fiscal 1997 level, which is estimated at \$22.4 million.

2) the previous change to a open-range, market-based matrix was in some measure designed to address the issue of pay compression resulting from a consistent lack of funding for step increases. The executive's plan returns to a complex system, vulnerable to the same issues of compression if the legislature does not consistently fund progression increases.

Executive Methodology to Fund the Proposed Pay Plan

The executive proposes to fund the costs of the proposed pay plan in the 1997 biennium entirely through reductions in FTE and vacancy savings. There are three primary issues associated with this methodology.

EXECUTIVE PAY PLAN

Disparity of Application

The following table shows the reductions made for purposes of funding the pay plan in the each agency, and shows that the actual impact to each agency is somewhat disparate. The information in the table was derived from final OBPP entries in the budget accounting system, and does not exactly conform to the printed executive budget.

Agency Name	Fiscal 1996 Total Present Law	Fiscal 1996 Vacancy Savings Reductions	Percent of Present Law	Fiscal 1996 FTE Reductions	Percent of Present Law	Total Reductions	Percent of Present Law
Legislative Auditor	\$2,523,863						
Legislative Fiscal Analyst	729,277						
Legislative Council	1,626,478						
Environmental Quality Council	263,655						
Consumer Counsel	284,523						
Judiciary	5,016,775	(\$80,072)	-1.6%		0.0%	(\$80,072)	-1.6%
Governors Office	2,083,615			(105,006)	-5.0%	(105,006)	-5.0%
Secretary Of States Office	977,105	(29,214)	-3.0%	(18,885)	-1.9%	(48,099)	-4.9%
Commissioner Of Political Prac	99,962						
State Auditors Office	2,473,155	(70,997)		(62,160)	-2.5%	(133,157)	-5.4%
Office Of Public Instruction	4,920,537	(244,392)	-5.0%			(244,392)	-5.0%
MSU-Billings College Of Tech	1,887,593	(15,243)	-0.8%			(15,243)	-0.8%
Butte College Of Technology	1,376,096	(13,071)	-0.9%			(13,071)	-0.9%
Msu College Of Technology - GF	2,475,075	(20,135)	-0.8%			(20,135)	-0.8%
Helena College Of Tech. - UM	2,276,423	(19,526)	-0.9%			(19,526)	-0.9%
College Of Technology, UM-Msla	2,826,410	(25,084)	-0.9%			(25,084)	-0.9%
Crime Control Division	639,919						
Highway Traffic Safety	310,024						
Department Of Justice	23,134,790	(1,037,088)	-4.5%	(35,320)	-0.2%	(1,072,408)	-4.6%
Public Service Regulation	1,676,932	(70,964)	-4.2%			(70,964)	-4.2%
Board Of Public Education	147,128						
Commissioner Of Higher Ed	2,855,382			(268,058)	-9.4%	(268,058)	-9.4%
University Of Montana	41,820,126	(491,247)	-1.2%			(491,247)	-1.2%
Montana State University	44,331,017	(467,924)	-1.1%			(467,924)	-1.1%
Montana Tech Of The U Of M	10,333,120	(109,453)	-1.1%			(109,453)	-1.1%
Montana State Univ. - Billings	12,793,298	(156,769)	-1.2%			(156,769)	-1.2%
Northern Montana College	7,057,323	(77,032)	-1.1%			(77,032)	-1.1%
Western Montana College	4,692,326	(53,575)	-1.1%			(53,575)	-1.1%
Agricultural Exper Station	8,411,698	(210,293)	-2.5%			(210,293)	-2.5%
Extension Service	4,663,632	(117,463)	-2.5%			(117,463)	-2.5%
Forestry & Coos Exper Station	628,660	0					
School For The Deaf & Blind	2,827,364	(84,006)	-3.0%	(52,498)	-1.9%	(136,504)	-4.8%
Montana Arts Council	312,211						
Library Commission	893,168	(44,289)	-5.0%		0.0%	(44,289)	-5.0%
Vocational Education Council	100,337				0.0%		
Historical Society	1,481,150	(58,905)	-4.0%	(17,126)	-1.2%	(76,031)	-5.1%
Fire Services Training School	204,113				0.0%		
Dept Of Fish, Wildlife & Parks	18,260,123	(490,343)	-2.7%	(302,252)	-1.7%	(792,595)	-4.3%
Dept Health & Environ Sciences	16,145,258	(553,731)	-3.4%	(255,617)	-1.6%	(809,348)	-5.0%
Department Of Transportation	69,477,810	(116,387)	-0.2%	(3,127,687)	-4.5%	(3,243,974)	-4.7%
Department Of State Lands	11,335,443	(331,359)	-2.9%	(205,563)	-1.8%	(536,922)	-4.7%
Department Of Livestock	4,021,184	(102,254)	-2.5%	(92,517)	-2.3%	(194,771)	-4.8%
Dept Nat Resource/Conservation	8,572,254	(234,650)	-2.7%	(192,118)	-2.2%	(426,768)	-5.0%
Department Of Revenue	18,721,606	(813,945)	-4.3%	(109,204)	-0.6%	(923,149)	-4.9%
Department Of Administration	11,098,998	(324,673)	-2.9%	(204,658)	-1.8%	(529,331)	-4.8%
Public Employees Retirement Bd	645,731	0.0%		(50,765)	-7.9%	(50,765)	-7.9%
Teachers Retirement Board	338,353	(6,553)	-1.9%	(10,210)	-3.0%	(16,763)	-5.0%
Department Of Agriculture	3,400,943	(11,947)	-0.4%	(152,882)	-4.5%	(164,829)	-4.8%
Corrections & Human Services	63,204,811	(160,658)	-0.3%	(945,818)	-1.5%	(1,106,476)	-1.8%
Department Of Commerce	11,647,500	(55,056)	-0.5%	(504,217)	-4.3%	(559,273)	-4.8%
Labor & Industry	20,805,104	(207,010)	-1.0%	(825,364)	-4.0%	(1,032,374)	-5.0%
Dept Of Military Affairs	3,098,954	(33,812)	-1.1%	(124,105)	-4.0%	(157,917)	-5.1%
Dept Social & Rehab Services	30,575,942	(1,059,145)	-3.5%	(467,008)	-1.5%	(1,526,153)	-5.0%
Department Of Family Services	18,475,816	(85,799)	-0.5%	(833,847)	-4.5%	(919,646)	-5.0%
Totals	\$510,980,090	(\$8,084,064)	-1.6%	(\$8,962,785)	-1.8%	(\$17,046,849)	-3.3%

Due to the highly individual, employee specific nature of the pay plan, the impacts on each agency of the executive's proposed implementation of a market grid are potentially highly variable. Therefore, funding of the unique funding requirements of each agency will not necessarily be uniform. The reductions in some agencies will subsidize pay plan costs in other agencies.

EXECUTIVE PAY PLAN

Use of Vacancy Savings

Over 47 percent of the personal services reductions are made through imposition of vacancy savings. Vacancy savings are those reductions in actual salary and other personal services costs from the budgeted level primarily due to: 1) time between termination of employment and rehire; and 2) potential rehire at lower salary due to reduced years of service. (As in the 1993 biennium, the executive is proposing a contingency appropriation for allocation to agencies that do not experience the level of vacancy savings required.) There are a number of issues involved with the use of vacancy savings to fund the pay plan.

Use of Vacancy Savings to Fund On-Going Costs

Because vacancy savings is highly dependent upon termination patterns, the rate of actual vacancy savings can fluctuate widely within programs and agencies from year to year. In addition, vacancy savings do not represent on-going savings, as do FTE reductions. The positions against which the vacancy savings are generated, as well as the salary obligations (including pay plan increases), remain in the next biennium. Vacancy savings do not provide an on-going source of revenue with which to pay on-going salary costs, either for individual agencies or for the state as a whole.

Disparity of Vacancy Savings Application Among Programs, Agencies, and Funding Sources

As shown in the table, the executive has not applied vacancy savings uniformly among agencies or programs. In addition, as noted in individual program narratives in the "Agency Budget Analysis" section, the vacancy savings applied do not consistently correlate to actual vacancy savings experienced in previous years.

Reduction of Legislative Options

With the exception of the 1991 biennium, the legislature has applied vacancy savings reductions to agencies. For the 1995 biennium, the legislature applied a 5 percent vacancy savings rate to most positions in state government. Use of vacancy savings to fund a particular executive initiative, and lack of uniformity in application among programs or agencies, reduces legislative options to apply anticipated vacancy savings for any other purpose.

Use of FTE Reductions

The executive intends to fund approximately 53 percent of the costs of the pay plan in the 1997 biennium through FTE reductions. Reductions in FTE represent on-going cost savings to the state. The executive proposes to eliminate over 286 FTE in fiscal 1996 and 294 in fiscal 1997. Issues in individual agency reductions are discussed in the "Agency Budget Analysis" section. One issue is discussed here:

Elimination of FTE with no Actual Cost Savings

Several of the FTE reductions shown as on-going savings do not represent true cost savings to the state, as the executive has replaced all or a portion of the savings with additional expenditures in present law. Of the total \$8.9 million in fiscal 1996 shown as personal services savings through reduction of FTE to fund the pay plan, approximately \$4.2 million is replaced through present law adjustments or other new proposals. The following table shows present law adjustments made to offset personal services reductions.

EXECUTIVE PAY PLAN

Table 7 Personal Services Reduction Replaced with Operating Expenses 1997 Biennium Executive Budget								
Agency	Adjustment	— New Proposal FTE Reduction —			— Present Law Increases —		— Net Increase (Reduction) —	
		Fiscal 1997 FTE	General Fund	Other Fund	General Fund	Other Fund	General Fund	Other Fund
DCHS	Radiological Technician	-2.00	(\$124,709)	\$0	\$31,248	\$0	(\$93,461)	\$0
DCHS	MSP Laundry Program	-18.00	(846,545)	0	1,039,132	0	192,687	0
DCHS	Program Evaluator	-1.00	0	(50,709)	0	28,800	0	(21,909)
DCHS	Privatize Pre-Release Centers	-18.60	(974,849)	0	1,598,009	0	723,160	0
DCHS*	Downsize MDC	-17.30	(559,090)	0	835,612	858,440	75,422	859,440
DFS	Wilderness Camp	-23.40	(1,594,087)	0	1,250,087	344,000	(344,000)	344,000
DNRC	Energy Use Inspectors	-1.00	0	(65,822)	0	65,822	0	0
DNRC	UIC Inspector	-3.00	0	(148,467)	0	225,000	0	76,633
Labor & Industry	Legal Services	-0.36	0	(13,228)	0	16,000	0	1,772
Livestock	Eliminate Helicopter Pilot	-1.00	0	(73,606)	0	108,000	0	34,395
Revenue	Corporate Tax	-0.25	0	(19,370)	0	20,000	0	830
State Auditor	Actuary	-1.00	(109,860)	(54,094)	0	20,000	(109,860)	(34,094)
Transportation	Privatize Data Entry	-2.00	0	(70,000)	0	40,000	0	(30,000)
Totals		-88.80	(\$4,209,140)	(\$495,295)	\$4,653,988	\$1,826,062	\$444,948	\$1,330,767
* \$135,500 in operations also reduced								

The individual agency narratives provide additional detail on each of these reductions.

SCHOOL EQUALIZATION ACCOUNT

State Support For K-12

During the 1995 biennium, state support for public elementary and high schools (K-12 grades) was \$904.7 million, as shown in Table 1. This is the single largest expenditure of state funds, dwarfing the 1995 biennial

general fund appropriation of \$391.0 million to operate state government agencies, \$215.5 million to the University system, and \$298.0 million for the departments of Family Services and Social and Rehabilitation Services.

Table 1
State Support for K-12 Education
1993, 1995 and Current Law 1997 Biennia
(In Millions)

Program	--- State Support ---		
	1993 Biennium	*1995 Biennium	**1997 Biennium
Foundation/Direct State Aid	\$702.6	\$539.1	\$546.2
Guaranteed Tax Base	92.1	266.1	285.2
Transportation	19.9	20.6	21.3
Special Ed	67.6	66.6	67.5
Other/OPI Administration	12.0	12.3	16.7
Total	\$894.2	\$904.7	\$936.9

*Actual for fiscal 1994, budgeted for fiscal 1995.

**Projected for the 1997 biennium, assuming no changes in current law.

State support for K-12 education increased substantially in fiscal 1991, when HB 28, a school equalization bill passed during the June 1989 Special Session, became effective. This bill increased foundation schedules by 14 to 24 percent and provided state guaranteed tax base (GTB) support for a portion of school general fund and retirement costs. This resulted in an increase of more than \$105.0 million in annual state expenditures for K-12 education between fiscal 1990 and 1991. This increase was nearly 32 percent of fiscal 1990 K-12 state expenditures.

The large schedule increase in fiscal 1991 was primarily a reallocation between state and local school district support. School general fund budgets increased by only 8.5 percent between 1990 and 1991, despite the large increase in state support. In fiscal 1992, state

support increased only slightly due to small increases in average number belonging (ANB), and then increased more rapidly in fiscal 1993, due to large increases in ANB. School general fund budgets, however, increased substantially faster than did state support during these two years. While state support increased an average of 1.5 percent per year in fiscal 1992 and fiscal 1993, school general fund budgets increased by 5.4 percent annually.

SCHOOL EQUALIZATION ACCOUNT

BASE Funding Schedules

During the 1993 regular legislative session, the legislature abandoned the old school foundation schedules. In their place the legislature passed HB 667, which created per-school and per-ANB entitlements. These entitlements are formula-driven and depend on the number of ANB and the level of special education funding. The new BASE system was implemented in the 1993-94 school year.

Difference Between Old and New Funding Mechanisms

The major difference between the new system of funding school districts' general fund budgets and the old system under the foundation schedules is that districts' general fund budgets are now constrained by a formula. The old foundation schedules merely constrained state spending. The old system partially constrained annual school general fund budget increases but, over the long run, districts were able to build budgets to whatever level voters would allow. Under the BASE funding system, no school may exceed the formula-driven maximum budget, unless its 1993 budget exceeded the maximum. In addition, after a 5-year phase-in, no district may budget below the BASE budget level. The purpose of the new system is to reduce spending disparities between similarly sized school districts and to stabilize the proportion of school costs paid by the state.

HB 28 had increased the old schedules to deal with the problem of inadequate state funding. In addition, HB 28 instituted a GTB system to subsidize low wealth schools in order to lower spending and taxation disparities among schools. These solutions were instituted in response to a Supreme Court ruling, in *Helena v. the State of Montana (No. 1)*, that deemed the Montana school system unequalized. Table 2 shows state funding for the general fund as a percent of total school general fund from fiscal 1990 through 1997. The state's share of school general fund spending rose sharply in fiscal 1991, but declined slowly thereafter.

Table 2
State Spending * as a Percentage
Of School General Fund

Fiscal Year	Percentage
1990	64.5
1991	75.9
1992	73.6
1993	69.9
1994	67.5
1995 **	66.7
1996 ***	67.0
1997 ***	66.1

* State spending for school general fund only

** Budgeted

*** Projected

HB 667 Funding Method

A second school funding suit was brought in 1991, contending that HB 28 had failed to alleviate spending disparities among school districts. In order to forestall this suit, the 1993 regular legislature passed HB 667, which installed the BASE funding system, limiting both state and school spending. The new system created maximum budgets and a BASE budget for schools, creating a tightly defined school general fund budget window. Also, HB 667 reduced the direct grant to schools, and expanded GTB funding for schools.

The maximum budget for a school district is the sum of its basic per-school entitlement, its per-ANB entitlement, and 153 percent of its special education allowable costs. Unless a school's 1993 budget already exceeded the maximum budget, no school's budget may exceed the maximum. In fiscal 1995 there were 64 schools, or 13.6 percent of all schools, with budgets above the maximum. These school budgets may not increase and, beginning in fiscal 1996, voters must approve any budget authority above the maximum. In fiscal 1995, several of these schools substantially reduced their general fund budgets by actions of the trustees.

SCHOOL EQUALIZATION ACCOUNT

The BASE budget for a school district is the sum of 80 percent of the district's basic entitlement, 80 percent of its per-ANB entitlement, and up to 140 percent of its special education allowable costs. Once a school has attained a budget that equals or exceeds the BASE budget level, its budget cannot fall below the BASE budget level. Schools which had budgets below the BASE budget level in fiscal 1993 were required to increase their budgets incrementally and must attain the BASE budget level by the 1997-98 school year. Budgets may increase faster than this schedule if voters approve additional budget authority. In fiscal 1995, there are 122 schools with budgets below the BASE budget level.

State direct aid supports half the BASE budget, and supplies GTB aid for the other half. Any spending beyond the BASE amount is not supported by the state, but must be funded by non-levy revenue or property taxes.

HB 667 changed the way ANB were counted for funding purposes. Under previous law, ANB was defined as average enrollment during the previous calendar year, adjusted for pupil-instruction related (PIR) days, and excluding students who spent more than one-half day in special education classes. Under current law, ANB is the average of the enrollment counts in October and February of the previous school year, adjusted for PIR days. In addition, beginning in fiscal 1995, students who spend more than one-half day in special education classes are included in the ANB count.

HB 667 also instituted a state reimbursement program for debt service expenditures associated with capital projects. Schools with debt service commitments from bonds sold after July 1, 1991 are eligible for the reimbursement if they are GTB-eligible. The legislature appropriated \$1 million per year for the program, which began in fiscal 1994. At the end of fiscal 1995, debt service payments for all bonds, including pre-1991 bonds, will be eligible for capital outlay GTB.

HB 22 Funding Method

Fiscal year 1994 was the first year of implementation of HB 667. During the November 1993 Special Session, the legislature made substantial changes in

the entitlement formula by enacting HB 22. Both per-school and per-ANB entitlements for fiscal 1995 were reduced by 4.5 percent. In addition, schools were required to reduce fiscal 1995 budgets by 4.5 percent, after which they were allowed to increase budgets by no more than 4 percent or 4 percent per ANB. These increases in budget authority require voter approval.

The result of the changes made in the November 1993 Special Session in HB 22 was to reduce state support costs for K-12 education. The 4.5 percent reductions in entitlements reduced direct state aid costs. However, the reductions were offset somewhat by the change in the method of counting ANB, as well as normal growth in ANB. The net effect of these changes was to reduce direct state aid by \$4.4 million between fiscal 1994 and fiscal 1995. This reduction in direct state aid was more than offset by a net increase in GTB costs of \$5.0 million between fiscal 1994 and fiscal 1995. GTB costs increased in spite of the reduction in entitlements because schools with budgets below the BASE level were forced to increase their budgets toward the BASE level in fiscal 1995. GTB costs will continue to increase faster than direct state aid costs until fiscal 1998, when all schools must budget at least at the BASE budget level.

Effects of the BASE Funding System on Spending Disparities

Spending disparities among school districts have traditionally been measured by calculating spending per ANB and then making adjustments for certain categorical expenditures, like special education costs and for certain receipts, namely the Public Law 81-874 receipts (PL874). Because economies of scale in the provision of schooling services has been recognized, spending disparities have been calculated for schools of similar size. Before HB 28, spending disparities were extremely high, with the largest disparities occurring in the small schools. These disparities were reduced with the introduction of HB 28, mainly due to much higher state support, which increased the amount spent by low spending schools. The implementation of HB 667, affecting the 1994 school year, and the passage of HB 22, which affected the 1995 school year, resulted in further declines in spending disparities.

Table 3 shows a comparison of spending disparities for elementary schools, high schools, and K-12 schools by

SCHOOL EQUALIZATION ACCOUNT

size category. The federal range ratio is the ratio of the highest spending school in each ANB size category to the lowest spending school in a size category, excluding the top spending schools with 5 percent of students and the low spending schools with 5 percent of the students. Fiscal 1992 data were presented by the plaintiffs in the second *Helena* case. Spending is defined as total general fund spending, excluding special education costs and PL874 receipts. Fiscal 1994 spending is defined as general fund budgeted spending, less special education costs.

ANB Size Category	Fiscal 1992**	Fiscal 1994	Fiscal 1995
Elementary			
1 - 9	2.62	2.66	2.59
10 - 24	2.19	3.23	2.43
25 - 40	2.99	2.31	1.77
41 - 100	2.82	2.67	2.34
101 - 300	1.85	1.52	1.41
> 300	1.45	1.32	1.28
High School			
1 - 24	2.96	2.51	2.28
25 - 40	2.05	2.00	1.63
41 - 100	2.53	1.63	1.54
101 - 200	2.91	1.40	1.37
201 - 300	1.83	1.66	1.57
301 - 600	2.09	1.36	1.26
> 600			
K - 12			
1 - 100	n/a	1.49	1.58
101 - 300	n/a	2.19	1.93
301 - 600	n/a	1.57	1.23
> 600	n/a	1.24	1.37

*Federal range ratio is ratio of spending per ANB for high spending school to low spending school in each ANB size category, excluding top 5 percent of students and bottom 5 percent of students.

** Plaintiffs data in *Helena et. al. vs State of Montana* (No. 2).

Fiscal 1995 spending is defined as general fund budgeted spending with no deductions for special education because, beginning in fiscal 1995, special education students are counted in ANB, and special education funds from the state are distributed on a per-ANB basis. Neither fiscal 1994 nor fiscal 1995 needed to be adjusted for PL874 since HB 667 removed these funds from schools' general funds.

HB 667 reduced spending disparities in almost every size category between fiscal 1992 and fiscal 1994. Spending disparities were reduced even further in fiscal 1995 because: 1) low spending schools were forced by HB 667 to spend closer to the BASE budget level; 2) high spending schools were required by HB 22 to reduce spending by 4.5 percent; and 3) the school boards of many high spending districts, anticipating they would have to submit spending authority above the maximum budget to their voters in fiscal 1996, permissively reduced budgets substantially in fiscal 1995.

The target spending disparity is 1.25 in each size category. This target corresponds to a target imposed by the federal government, which requires this level of equalization before a state may require schools to use PL874 to offset state aid. Between now and fiscal 1998, disparity ratios in Montana schools will continue to fall as low spending schools are forced to budget at higher levels, and high spending schools either maintain their budgets or are forced by voters to reduce budgets. However, even if all schools were to budget between the base budget and the maximum budget, it is unlikely that the federal target disparity ratio of 1.25, as measured by spending per student, would be reached. This is especially true for elementary schools with junior high students. The funding mechanism treats junior high students as high school students for funding purposes. Thus, schools with high concentrations of junior high students will continue to spend at higher average per-student levels than elementary schools with low concentrations of junior high students.

Special Education Funding

HB 667 substantially changed the way programs for special education are funded. In fiscal 1994, the general fund appropriated to pay for special education needs was based on special education program needs

SCHOOL EQUALIZATION ACCOUNT

as determined by OPI. Under the new system, beginning in fiscal 1995, each school receives an instructional block grant, and a related services block grant based on its special education expenditures per ANB in the previous year. Each school must provide \$1 of local revenue to match every \$3 in block grant funding from the state. The new procedure provides for recapture of unmatched state special education expenditures and contingency requests.

Executive Proposals for K-12 Funding

The executive proposes changing capital outlay and transportation funding for the 1997 biennium and increasing equalization aid for increasing enrollment.

Capital Outlay Equalization

The executive proposes increasing the amount the state reimburses eligible school districts for their capital debt service expenditures. Under current law, the state spends \$1 million a year in capital reimbursement aid to schools with debt service payments associated with bonds that were sold after July 1, 1991. After fiscal 1995, debt service payments for all school facilities will be eligible for state reimbursement aid, including schools with pre-1991 bonds. The executive proposes increasing the amount available in state aid during the 1997 biennium to \$1.5 million in fiscal 1996 and \$2.0 million in fiscal 1997. In addition, the executive proposes making permanent the qualification that only bonds sold after July 1, 1991 would be eligible for the capital outlay aid.

A school district must be GTB-eligible to be eligible for the state reimbursement. Its taxable value per ANB must be below the state average taxable value per ANB. Under the formula, a school district's school facility entitlement is a set dollar amount per ANB. If a school is GTB-eligible, its school facility reimbursement is the lesser of its actual debt service expenditures or the calculated reimbursement. When the total available reimbursements required exceed the amount available from the state, the reimbursements are prorated. In addition, a school does not receive a reimbursement in the first year a new facility is built. Instead, the district must levy mills for debt service for its full first year debt service payment, for which it will

be reimbursed in the second and later years. The executive also proposes allowing reimbursements in the first year a facility is in operation.

In fiscal 1994, there were 14 school district which received a portion of the \$1 million available for capital outlay aid. The total amount of debt service supported by this aid was \$3.9 million. The average amount of state reimbursement aid as a percent of school debt service payments was 25.6 percent. The amount available in fiscal 1994 for capital outlay aid, \$1 million, was enough to provide every requesting school with 90 percent of its calculated reimbursement amount. It is expected that in fiscal 1995, the proration percentage will decline to between 65 and 70 percent.

The executive proposal to permanently restrict capital reimbursement aid to schools for bonds sold after July 1, 1991 would eliminate state obligations of \$20.4 million for pre-1991 bonds. Extending eligibility for this aid to schools with debt service obligations for bonds sold before this date could severely dilute the amount of capital reimbursements schools are currently receiving.

If the executive's proposal to admit eligibility for bonds sold after July 1, 1991 is passed, but the additional aid request is denied, it is possible that schools that currently receive reimbursements will receive less than they do now. This would be true if enough schools pass bond issues, or if a few large schools pass bond issues. In the past year, at least 10 schools attempted and failed to pass bond issues. The total annual debt service requirements for these requests was nearly \$4 million, which would have increased the state's reimbursement outlays, in the absence of the \$1 million limit, by over \$500,000. Since the state reimbursement limit and proration are in effect, passage of these bond issues would have resulted in reduced payments to schools currently receiving state reimbursements. It is expected that these schools will attempt further building bond issues in the future, possibly for reduced amounts.

An obvious barrier to financing additional debt in many of these school districts is taxpayer resistance to higher property taxes. The state's reimbursement does not reach the school district until the second year, thus requiring high first year mill levies, in some cases. For

SCHOOL EQUALIZATION ACCOUNT

instance, some school districts may experience first year mill levies of 50 to 60 mills, which may fall by 50 percent or more after reimbursement. The executive proposal to make reimbursements in the first year may result in removing a voter disincentive to approve additional taxes. To the extent this occurs, the additional requests for reimbursement aid would result in a dilution of existing aid, unless the administration's request to increase reimbursement aid is also granted.

Transportation

The executive is requesting a \$1.72 million general fund supplemental to allow the state to reimburse school districts for transportation costs in accordance with the payment schedules set forth in sections 20-10-140, MCA; 20-10-142, MCA; and 20-10-145, MCA. In June 1994, the Office of Budget and Program Planning approved a transfer of \$800,000 from the fiscal 1995 general fund appropriation for school transportation costs incurred in fiscal 1994. The fiscal 1995 supplemental request includes \$800,000 to replace the amount transferred, plus an additional \$920,000. By statute, the state must reimburse school districts for the transportation costs incurred by a school district in transporting eligible students to and from school.

According to OPI, the increase in school transportation payments is due to a combination of: 1) additional bus routes; 2) a growing number of students riding school buses; and 3) a decline in the school district transportation cash reserves available to reduce the state's share.

Two general fund supplementals approved by the legislature for school transportation were: 1) \$281,586 for fiscal 1987; and 2) \$215,000 for fiscal 1989.

The Executive Budget request for transportation aid to school districts for fiscal 1996 is \$10.6 million, of which \$6.7 million is general fund. This is \$467,761 above the fiscal 1994 base budget of \$10,132,329, which includes the expenditures from the advance of \$800,000. The fiscal 1997 request is \$10.7 million, an increase of \$567,761 above the fiscal 1994 base budget. These increased requests are the result of anticipated increases in the number of students riding school buses.

Of the \$800,000 transfer to cover fiscal 1994 costs, OPI spent only \$558,983. OPI has requested \$800,000 in reimbursement for this expenditure, plus an additional \$920,000 for fiscal 1995. The justification for the high supplemental request is to meet maximum transportation aid requests that districts could be entitled to in fiscal 1995. OPI is not able to say why districts do not now budget at the maximum entitled amount.

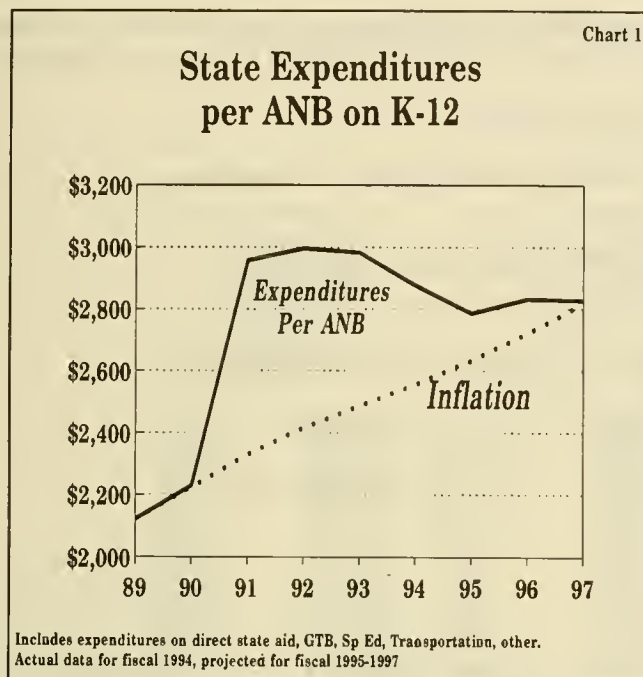
Equalization Aid

The executive is not requesting any increase in the basic per-school and per-ANB entitlement amounts for schools. State support costs will therefore increase only with the growth in ANB. The per-ANB amount that will be spent by the state in the 1997 biennium will remain nearly equivalent to the amount spent by the state in fiscal 1995, which was reduced from the amount spent in fiscal 1994. The reduction in fiscal 1995 was the result of a 4.5 percent cut in entitlements in HB 22 passed in the November 1993 Special Session.

The last major increase in state funding for K-12 was in fiscal 1991 as a result of the passage of HB 28. Chart 1 shows state expenditures per ANB compared with inflation since 1989. The inflation index used was the Consumer Price Index for all goods and services. While it can be argued that a better measure of inflation to which to compare school funding might be a measure of the cost of school operations, no such index exists. However the prices of many resources employed in schools operations, such as energy, food, books, supplies and materials, are increasing approximately with general inflation. In addition, the main component of schools operation, teacher salaries, may also increase by a rate near that of inflation.

State expenditures per ANB have remained nearly flat or have declined since 1992, the second year of operation under HB 28. State expenditures per ANB fell slightly in fiscal 1993 and then fell nearly 3.6 percent, or \$106 per ANB in fiscal 1994, the first year of operation under HB 667. State expenditures per ANB were reduced even further in fiscal 1995, as HB 22 reduced entitlements, and special education students were counted for the first time. The fiscal 1995 reduction was 3.1 percent or \$89 per ANB.

SCHOOL EQUALIZATION ACCOUNT

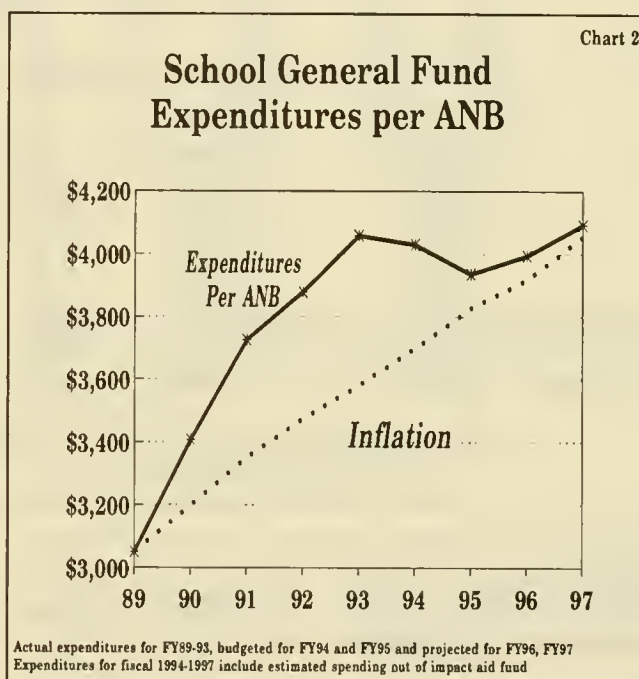


State aid per ANB for fiscal 1996 and 1997 is expected to increase slightly from the level observed in fiscal 1995. This is because low spending schools, who are required to close the gap between prior year budgets and the BASE budget level, will become eligible for additional GTB aid. Once these schools are at the BASE budget level the only way that state expenditures per ANB can increase is through legislated changes in entitlements or in the level of categorical expenditures, such as special education payments.

In inflation adjusted dollars, state spending per ANB in fiscal 1997 will be nearly equivalent to the amount spent in fiscal 1989, before HB 28 was passed. This will represent 66.1 percent of total school general fund spending (see Table 2), higher than the amount in fiscal 1990, but lower than the proportion in fiscal 1991, the first year of implementation of HB 28.

School general fund expenditures per ANB have followed much the same pattern as state expenditures per ANB. Chart 2 shows that school general fund expenditures per ANB peaked in fiscal 1993, the last year of operation for HB 28. For fiscal 1994 through fiscal 1997, general fund expenditures have been adjusted upward by estimated PL874 spending to make these years comparable with previous years. This

adjustment is necessary because HB 667 required schools to budget PL874 in a separate account beginning in fiscal 1994. Also, in fiscal 1994, the first year that HB 667 was in operation, general fund budgets per ANB were reduced by \$28, or less than 1 percent. The larger reduction in fiscal 1995, in response to the mandated reduction in entitlements in HB 22, was \$94 per ANB or 2.3 percent.



In inflation adjusted dollars, the level of general fund spending per ANB by school districts in fiscal 1997 will be, on average, nearly equivalent to the amount spent in fiscal 1989. There are still wide variations in spending per ANB among school districts, as evidenced by the federal range disparity ratios in Table 3. The level of spending shown in Chart 2 assumes that high spending schools will maintain their budgets at current levels in fiscal years 1996 and 1997. If these schools reduce their budgets, average spending per ANB will be reduced even further.

Comparison of LFA Present Law K-12 Costs with Executive

Enrollment in Montana schools is on the upswing. Montana had stable or declining enrollments throughout the 1980's. However, enrollment began increasing in fiscal 1992, and OPI projects that this

SCHOOL EQUALIZATION ACCOUNT

increase will continue throughout the 1997 biennium, as Table 4 shows. Funding the present law BASE

schedules for these additional students will increase SEA costs by over \$27.0 million in the 1997 biennium.

Table 4
Average Number Belonging (ANB) in Montana Schools
FY1988 - 1997

Year	Elementary	% Change	High School	% Change	Total	% change
1988	103,777		46,485		150,262	
1989	104,386	0.59	44,932	(3.34)	149,318	(0.63)
1990	105,763	1.32	43,327	(3.57)	149,090	(0.15)
1991	105,593	(0.16)	42,407	(2.12)	148,000	(0.73)
1992	106,579	0.93	41,890	(1.22)	148,469	0.32
1993	108,523	1.82	42,614	1.73	151,137	1.80
1994	111,497	2.74	45,457	6.67	156,954	3.85
1995 *	114,758	2.92	47,811	5.18	162,569	3.58
1996 **	114,748	(0.01)	49,713	3.98	164,461	1.16
1997 **	114,840	0.08	51,671	3.94	166,511	1.25

* Includes for first time students who spend more than 1/2 day in special education class

** OPI projections of ANB

ANB Differences Between the Executive and LFA

The executive estimates of K-12 costs for fiscal 1995 and the 1997 biennium utilized the same ANB estimates as those used by the LFA. The one exception is the number of ANB for fiscal 1995, which is 5 ANB fewer than the executive because the executive did not have available fiscal 1995 budget data.

Cost Differences Between the Executive and LFA

Table 5 presents a comparison of Executive Budget SEA costs with those of the LFA for fiscal 1995 and the 1997 biennium. The Executive Budget estimates were prepared before the fiscal 1995 school budget data were available, whereas the LFA estimates were prepared after this data became available. The major differences between the executive and LFA estimates are in the areas of direct state aid, GTB aid for school general fund and county retirement, and other costs.

SCHOOL EQUALIZATION ACCOUNT

Table 5
Actual and Projected Sea Costs
Comparison of Executive Proposed and LFA Present Law
Fiscal 1994 - 1997 (In Millions)

Cost Component	Actual Fiscal 1994	LFA Fiscal 1995	Executive Fiscal 1995	--- Projected ---		LFA Fiscal 1997	Executive Fiscal 1997
				LFA Fiscal 1996	Executive Fiscal 1996		
Direct State Aid	\$271.760	\$267.313	\$267.316	\$271.225	\$272.113	\$275.011	\$275.831
Guaranteed Tax Base							
General Fund GTB	111.490	116.511	114.944	119.294	118.978	122.440	120.770
County Retirement GTB	17.085	18.985	18.571	20.148	20.148	21.366	21.366
Capital Outlay GTB	1.000	1.000	1.000	1.000	1.500	1.000	2.000
Transportation	3.908	3.914	3.914	3.908	3.908	3.914	3.908
OPI Administration	0.322	0.078	0.078	0.000	0.000	0.000	0.000
Telecommunications Network	0.177	0.223	0.223	0.200	0.200	0.200	0.200
SIMMS	0.500	0.500	0.500	0.500	0.500	0.500	0.500
Other	0.151	1.200	0.600	1.200	0.100	1.200	0.100
Total Disbursements	\$406.387	\$409.724	\$407.146	\$417.475	\$417.447	\$425.631	\$424.675
ANB	156,954	162,569	162,574	164,461	164,461	166,511	166,511

Direct State Aid

Direct state aid estimates are calculated using a school funding model which may differ depending on the growth rates assumed for K-6 ANB and 7-8 ANB. The LFA estimates were based on OPI projections of these enrollments. For the three-year period, fiscal 1995 through fiscal 1997, direct state aid estimates supplied by the executive exceed the LFA estimates by \$1.7 million. However, the executive estimates include an adjustment of \$1 million per year for possible budget amendments. The LFA estimates include the same amount for budget amendments in other costs.

General Fund GTB

The LFA estimates of school general fund GTB exceed those of the executive by \$3.6 million. The primary reason for this difference is that schools had budgeted substantially lower unreserved fund balance reappropriated in fiscal 1995 than was assumed in the executive estimates. Unreserved fund balance reappropriated is the amount of fund balance in excess of 10 percent of a school's budget remaining at the end of the previous school year. Schools must apply unreserved fund balance reappropriated dollars to their GTB budget before calculating the amount of GTB subsidy in the current year. The executive assumed that the amount of unreserved fund balance reappropriated was the same as was available in fiscal 1994, approximately \$25 million. The fiscal 1995 budgets revealed that schools had budgeted

approximately \$15 million in unreserved fund balance reappropriated. Therefore, GTB subsidy costs for the state will be higher in fiscal 1995 and throughout the 1997 biennium.

County Retirement GTB

The LFA estimates of county retirement GTB exceed those of the executive estimates only in fiscal 1995. This may also be due to lower LFA estimates of unreserved fund balance reappropriated in county retirement budgets.

Capital Outlay GTB

The estimates for capital outlay GTB differ only in fiscal 1996 and fiscal 1997. The executive numbers reflect a proposal to increase funding for this item by \$500,000 a year in the 1997 biennium.

Other Costs

Other costs include: expenses associated with Department of Commerce audits, bonus payments for schools which consolidate, and a contingency amount for school budget amendments for direct aid.

The executive included a school budget amendment contingency amount in its direct state aid estimates. When the growth in student enrollments in the current year exceeds enrollments from the previous year by six percent or more, schools may apply to OPI for

SCHOOL EQUALIZATION ACCOUNT

increased direct state aid for the students in excess of the six percent growth. The amount of additional state aid paid out as a result of school budget amendments was \$2.0 million in fiscal 1993 and \$1.1 million in fiscal 1994. The LFA estimate of other costs assumes the school budget amendments from fiscal 1995 through fiscal 1997 will be \$1 million per year.

STRUCTURAL IMBALANCE

General Fund Potential Deficit

The 1993 legislature addressed the issue of a continuing structural imbalance in the general fund that had occurred for the prior six biennia, where expenditures consistently exceeded revenues. The 1993 regular session left general fund revenues and expenditures nearly matched for the 1995 biennium. However, with the suspension and later repeal of HB 671 by voter initiative, over \$72 million in anticipated tax revenues were eliminated. The legislature in the November 1993 Special Session, after re-balancing the general fund, again nearly matched general fund revenues and expenditures in fiscal 1995.

Although general fund revenues and expenditures are nearly matched in fiscal 1995, the large budget increases recommended by the executive will have to be complemented by at least as much growth in revenues in order to maintain a structural balance in the general fund. The Executive Budget proposal includes total disbursements during the 1997 biennium of \$1,381.5 billion. When compared to Executive Budget revenue estimates, there is a near match of revenues and expenditures. But when this is compared to total revenue estimates as recommended by ROC of \$1,355.4 billion, the difference between ongoing revenues and proposed expenditures is \$26.1 million. There is a shortfall of ongoing revenues to support the executive proposal for ongoing expenditures in the 1997 biennium, creating a structural imbalance in the account. This imbalance will be exacerbated in future biennia by the following anticipated growth in expenditures in the 1999 biennium and beyond that will have to be addressed by future legislatures.

One-Time Revenues

The executive proposal includes at least \$10 million in one-time revenue sources that will not be available in future bienniums. These include \$5.0 million of one-time revenues from adoption of the Project 95 oil and gas tax reform (discussed on page Tax Policy 6) and \$5.2 million in coal tax revenues that are diverted from coal tax revenues to the general fund in fiscal 1996 only, and are used for the capital projects fund in fiscal 1997 and beyond.

Medicaid Cost Increases

Medicaid costs have been increasing at double digit rates over the past several years, although they slowed to 8 percent in fiscal 1994. The general fund budget approved in the 1993 regular legislative session for primary care medicaid (inpatient and outpatient hospitalization, doctors' services, drugs) grew at an annual rate of 22 percent compared to fiscal 1992 base year costs. Increases are fueled by medical cost inflation, which historically has outstripped general price inflation, federal mandates requiring states to extend medical coverage to additional groups, increased service utilization, and improvements in medical technology that successfully treat conditions that previously were terminal. The Executive Budget projects a biennial cost increase of \$25.9 million.

Schools' Average Number Belonging (ANB)

Precise estimates of changes in school ANB counts in K-12 education are not available. In general, however, growth in all ANB follows population trends. The recent growth in population in the early 1990's is expected to continue during the middle of the decade, but probably at a slower pace. The mix of elementary and high school students in the ANB count is also expected to continue the trend begun in the early 1990's. Children of the "baby boom generation" in the 1950's and 1960's are beginning to enter high schools. The growth in high school populations during the 1997 biennium and beyond will be greater than the growth for elementary grades.

Pay Plan Cost Annualization

The executive pay plan proposal would require an estimated \$16.2 million general fund in the 1997 biennium. The pay plan increases will occur throughout the 1997 biennium. When the pay plan is annualized for carryforward into the 1999 biennium, there will be a significantly increased cost over the 1997 biennium.

STRUCTURAL IMBALANCE

Vacancy Savings

The Executive Budget recommends applying a vacancy savings reduction in agency personal services budgets of an average 1.6 percent in the 1997 biennium. The vacancy savings is applied as one of two primary means of "funding" the 1997 biennium pay plan. The executive proposes to fund the plan within existing budgets, by holding positions vacant and by reducing FTE. Although the elimination of FTE provides a permanent savings, vacancy savings reductions are temporary. The positions are fully funded in the next biennium, and will add a general fund cost of approximately \$6.5 million in the next biennium.

Guaranteed Annual Benefit Adjustment - Pension Plan

The Executive Budget recommends a guaranteed minimum annual benefit adjustment (based on the consumer price index) to current and future retirees in the eight state retirement plans. The proposal would cost an additional \$5.0 million in the 1995 biennium, but would increase to \$11 million in the 1999 biennium, and \$13.6 million in the 2001 biennium.

Proposed Funding Switches

The Executive Budget proposes to shift funding of the Highway Patrol Division in the Department of Justice from highways special revenue funds to general fund, in order to dedicate highways funds directly toward an expanded construction program. The cost funded in the current biennium from highways special revenue funds for the Highway Patrol Division is \$27 million. This would add a significant increase in general fund costs in the 1999 biennium.

The cost increases discussed above will put a severe strain on the ability of existing general fund revenue sources to fund present law needs, even if the current economic upswing continues. Clearly, the state budget cannot attain long-term structural balance if large expenditure areas such as human services benefits continue to grow faster than revenue sources.

GUARANTEED ANNUAL BENEFIT ADJUSTMENT PROPOSAL

Executive Proposal

The executive proposes a guaranteed annual minimum benefit increase to current and future retirees in all eight public retirement plans, and their beneficiaries. This proposal is referred to as the guaranteed annual benefit adjustment (GABA) proposal. The plan would increase retirement benefits annually by at least 2 percent but by no more than the change in the Consumer Price Index (CPI) in the previous year. The plan would affect the Public Employees' Retirement System (PERS), Teachers' Retirement System (TRS), Game Wardens' Retirement System (GWRS), Sheriffs' Retirement System (SRS), Judges Retirement System (JRS), Highway Patrol Officers' Retirement System (HPORS), Municipal Police Officers' Retirement System (MPORS), and the Firefighters' Unified Retirement Systems (FURS). The enhanced benefit adjustment would be available for members who were retired, and to benefit recipients whose benefit initiation date was at least 36 months previous to January 1 of the year in which the adjustment is to be made. The permanent monthly benefit adjustment would be available on January 1, 1996.

The stated reason for the GABA proposal is to provide a systematic benefit adjustment mechanism designed to save costs associated with ad hoc benefits adjustments that may to be enacted in the future. These ad hoc adjustments are detrimental to retirement system actuarial soundness because they are rarely financed with increases in pre-retirement contribution rates that can be invested, but instead provide benefits from current operating accounts.

Costs of the Proposal

Estimates provided by the executive indicate that enactment of GABA would increase state general fund costs by \$5.1 million in the 1997 biennium, \$11.0 million in the 1999 biennium and \$13.6 million in the 2001 biennium. There would be GABA associated costs in all funds used to pay the state share of retirement contributions.

A share of the increased costs would also be borne by the university system, schools and local governments.

Benefit Changes

The GABA benefit increases experienced by retirees would vary depending on the retirement system. For systems for which all retirees would gain benefits, such as PERS and TRS, all retired members would be required to participate in GABA. For other systems in which some retirees might receive lower benefits under GABA due to the loss of previously enacted benefit adjustments, participation in GABA would be optional for any retirees who became members before July 1, 1995.

GABA Funding

Funding for GABA also varies by retirement system. In general, funding would come from one or more of the following sources:

- Current Post-Retirement Adjustment (PRA) - when a retirement fund earns a rate of return above the current actuarial assumption for the investment rate of return, the excess is added to the retiree's benefit. This is as under current law and would not change under GABA.
- Funding swaps - under current law, retirees from one system may buy into another system, or may buy additional years of service in a system. GABA would require that these purchases be made at full actuarial cost, which exceeds the level at which these purchases may currently be made. Purchasing at full actuarial cost would reduce the need for future employer/employee contribution increases and therefore result in state cost savings.
- Employer contributions - employers in all systems would be required to increase contribution rates. For PERS and TRS, these increases would be phased in until rate stabilization occurred in fiscal 1999. State employer contribution dollars would come from a combination of accounts including general fund, state special, School Equalization Account (for County Guaranteed Tax Base), and foregone insurance tax premiums to the general fund. Local government and county school district contribution dollars would come from a combination of increased mill levies, state county retirement GTB, and increases in the share of insurance premium taxes to retirement funds.

GUARANTEED ANNUAL BENEFIT ADJUSTMENT PROPOSAL

- Employee contributions - employees would be required to contribute at increased contribution rates. For PERS and TRS, these increases would be phased in until rate stabilization occurred in fiscal 1999.

- Extend amortization period - some systems use amortization periods less than the maximum required by law. Extending amortization periods reduces the rate of increase on future employer/employee contribution rates.

- Utilize system funding - by July 1, 1995 two of the retirement systems contribution rates will exceed the amounts actuarially required to fund current benefit levels. This excess in contribution amounts would be used to fund GABA increases for these systems.

INFLATION/DEFLATION FACTOR ISSUES

The Executive Budget proposes that specific operating cost items be inflated or deflated by the inflation factors agreed to by the LFA in the summer of 1994. The inflation factors utilized are presented in the "Reference" section of this report.

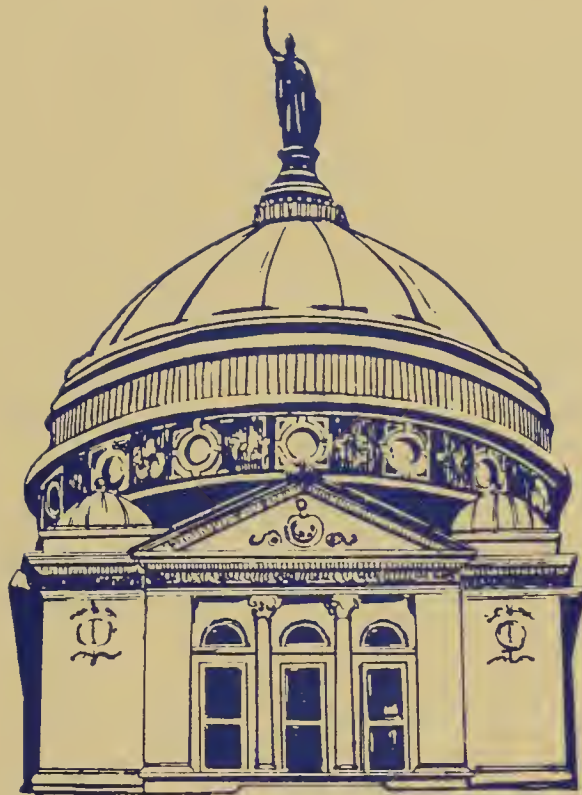
The legislature should be aware of two issues relative to the inflation factors used to adjust operating costs:

- The inflation factor used to inflate costs associated with postage and mailing will be below the actual increase in the costs incurred during the 1997 biennium. This is because the inflation factors utilized were based on the federal government increase in postage stamp prices on January 1, 1996. Recently, the U.S. Postal Service announced an increase of 3 cents per postage stamp effective January 1, 1995.
- Inflation factors were applied only to selected expenditure codes including those for food, medical, and energy related items as well as proprietary items; books and reference material; and postage and mailing. All other operating costs items were not adjusted for inflation.

The fiscal 1994 general fund operating cost items inflated represent only 34 percent of all general fund operating cost items. Applying inflation factors to the selected general fund items increased present law 1997 biennium expenditures by \$1.8 million. If the remaining fiscal 1994 general fund expenditures had been inflated by the general Consumer Price Index (CPI), present law general fund expenditures for the 1997 biennium would have increased by \$5.5 million.

For all funds, the fiscal 1994 operating cost items inflated represent 15 percent of all funds operating cost items. Applying inflation factors to the selected expenditure items for all funds increased present law 1997 biennium expenditures by \$9.5 million. If the remaining fiscal 1994 funds operating costs items had been inflated by the Consumer Price Index (CPI), present law all fund expenditures for the 1997 biennium would have increased by \$66.6 million.

INFLATION/DEFLATION FACTOR ISSUES



OTHER FISCAL ISSUES

SB 378 - DEDICATED REVENUE PROVISIONS

SB 378 Interim Study

SB 378 (enacted by the 1993 legislature) requires the Legislative Finance Committee (LFC) to review in the interim each dedicated revenue provision to ensure they:

- are based on sound principles of revenue dedication;
- reflect legislative priorities for state spending; and
- are terminated when no longer needed.

The LFC is also directed to review all statutory appropriations to determine if the appropriation should be made by a legislative appropriation, with emphasis on those that fund administrative costs. Specific evaluation criteria to be used in the review are provided in statute. The law directs the LFC to establish procedures that facilitate the review and evaluation of the provisions. The committee's findings are to be reported to the legislature, including the purpose, funding source, activity funded, number of personnel funded, and fund balance of each dedicated revenue provision. This detailed report is available from the Office of the Legislative Fiscal Analyst (LFA). The following provides a summary of the review and the committee's recommendations.

The LFC reviewed 364 dedicated revenue provisions and 95 statutory appropriations. To facilitate the review of state special revenue accounts, the LFA and the Department of Administration (DofA) cooperated and surveyed the administering agency of each state special revenue account. The information was entered in a computer database and accounts were classified into 17 categories. Of the 364 state special revenue accounts reviewed, the committee determined that 61 could be eliminated.

SB 378 allows certain categories of accounts to be exempt from future review. From the committee's review of all dedicated revenue provisions, it recognized that, due to constitutional restrictions or the special nature of some funding sources, some state special revenue accounts clearly should not and need not be de-earmarked. The committee determined that accounts in nine categories (98 accounts) could be

exempt from future reviews of dedicated revenue provisions.

The committee directed staff to review and monitor 33 accounts that may have excessive fund balances and, after further review, include an issue in the LFA budget analysis if deemed appropriate. The committee also directed staff to work with the DofA to review 25 accounts that could possibly be eliminated or reclassified.

The committee approached its work on SB 378 with a philosophy that the review of state special revenue funds should better enable the legislature to include these funding sources in its review and prioritization of program funding. The committee was sensitive to the fact that some programs funded by these sources may not receive as close legislative scrutiny as programs funded by general fund, and that the legislature's flexibility to allocate funding may be limited. The committee recognized that some funding sources currently deposited to state special revenue accounts are general in nature and not required by law to fund specific programs. These funds are the current candidates for possible de-earmarking to the general fund so that the funds could be prioritized by the legislature along with general fund used to fund other programs. The committee concentrated on four sources of revenue that could be considered general in nature and not collected for a specific use. These sources include: 1) taxes; 2) fines & forfeitures; 3) interest; and 4) investment earnings.

Two bills will be introduced to the 1995 legislature implementing the recommendations of the LFC. The following narrative summarizes this legislation.

Proposed Legislation

To implement the LFC's recommendations for de-earmarking, the following statutory amendments are proposed:

State Special Revenue

1. De-Earmarked Certain Accounts - The LFC recommends that the following accounts be de-earmarked and revenue deposited to the general fund.

SB 378 - DEDICATED REVENUE PROVISIONS

a. School Equalization Account (SEA) Revenue Sources - By law, any deficit in the SEA must be paid by the general fund and any surplus in the SEA reverts to the general fund. Because of the tight link between the SEA and the general fund, and the large amount of earmarked revenue, the committee determined that SEA revenue sources are good candidates for de-earmarking to the general fund. SB 378 already de-earmarked a portion of the SEA revenue by depositing income and corporation tax revenue to the general fund beginning in fiscal 1995. It also de-earmarked interest earnings from coal severance tax funds. The funds deposited to the general fund from current SEA will be separately tracked and accounted for.

b. Lodging Facilities Tax Revenue (15-65-121, MCA) - All revenue from this tax would be deposited in the general fund for the legislature to appropriate for any use. Programs currently funded with this tax revenue include: Department of Commerce, regional non-profit tourism corporations, Department of Fish, Wildlife, and Parks (FWP), Commissioner of Higher Education, Montana Historical Society. The money would no longer be statutorily appropriated.

c. State's Half of Fines and Penalties Collected in Justices' Court (3-10-601, MCA) - Revenue from this source would be deposited in the general fund for the legislature to appropriate for any use. Programs currently funded with the revenue include: traffic safety education, crime victim's benefits, highways, game warden's retirement, battered spouses, and livestock inspection and control.

d. FWP Fines and Restitutions, DHES Civil Penalties, and Miscellaneous Fines and Forfeitures - Section 87-1-

111, MCA, would be amended to deposit all Department of Fish, Wildlife and Parks fines in the general fund including: restitution payments collected for illegally killing or possessing certain wildlife, motorboat certification identification fines, snowmobile registration fines, and off-highway vehicle fines.

Section 75-5-507 and 75-6-115, MCA, would be amended to deposit Department of Health and Environmental Sciences civil penalty fines in the general fund, including fines from violations of water quality statutes (the statutory appropriation would be eliminated), and violations of the public water supplies, distribution, and treatment statutes.

In addition, statute would be amended to deposit all miscellaneous fines and forfeitures, except those deposited in the Department of Natural Resources and Conservation's Broadwater Arbitration Account, in the general fund. The statutory appropriation would be eliminated for revenue from the sale of property seized and forfeited in connection with an arrest for violation of dangerous drug laws.

2. Combine five current allocations of coal severance tax revenue (equalling 8.36 percent of total collections) into one account for appropriation by the legislature (15-35-108, MCA). The legislature would prioritize and appropriate the available funds in the account for: a) local impact; b) Montana Growth Through Agriculture; c) county land planning; d) State Library Commission; and e) conservation districts. Statutory references to these accounts would be eliminated.

3. Require separate accounts for the constitutionally restricted revenue in the departments of Transportation and Livestock. The Montana constitution provides that certain revenue be used for specific purposes. Article

SB 378 - DEDICATED REVENUE PROVISIONS

VIII, Section 6 of the Montana constitution provides that revenue from gross vehicle weight fees, and excise and license taxes on fuel be used for specific purposes unless three-fifths of the members of each house of the legislature directs it elsewhere. Article XII of the Montana constitution states revenue derived from special levies on agricultural commodities shall be used solely for the purposes of the levies. Because revenue collected from these sources is afforded certain protection by the constitution, the legislature is limited in its ability to divert this revenue for other uses. The LFC is concerned that, in these two cases, constitutionally protected revenue are being commingled with non-constitutionally protected revenue. Because this practice makes it difficult to separate the revenue protected by the constitution from other revenue, the flexibility of the legislature in using these funds is lessened.

4. Eliminate statutory reference to the worker's compensation "tax account" (39-71-2504, MCA) that serves no purpose other than for an in-and-out transfer of old fund liability tax funds to the workers' compensation bond repayment account.
5. Amend SB 378 statutes by adding principles and criteria of revenue dedication and statutory appropriations, and eliminate the DofA biennial study of state special revenue and proprietary fund accounts. Although statute enacted by SB 378 refers to principles of revenue dedication, they are not defined in statute. The amendments would put these principles in statute and direct certain legislative and executive agencies to apply the principles and criteria in the normal course of their duties.

The amendments also identify the criteria for determining statutory appropriation authority. Funding should not be statutorily appropriated if it is used to fund administrative costs of state government and if the appropriation has a continuing and reliable source of revenue.

Because SB 378 requires a review of revenue dedication by the LFC, a duplication of effort exists with the current review by the Department of Administration. The amendments eliminate the department's review role and instead require the department to conduct a revenue dedication survey and to subsequently supply the survey information to the LFC.

Statutory Appropriations

1. Eliminate 14 statutory appropriations. The following statutory appropriations are targeted for elimination because: a) they are used to fund administrative costs and have a continuing and reliable sources of revenue; or b) they were targeted to be eliminated in amendments discussed above. If any of these appropriations are removed from statute, future funding for the programs would need to be appropriated in the general appropriations act.
 - a. Judiciary (03-05-901, MCA) - Appellate Defender program is located in the DofA. The program was first funded in fiscal 1992 with revenue received from the two percent tax collected on motor vehicles.
 - b. Department of Revenue (15-25-123, MCA) - Appropriates revenue from the tax on possession and storage of dangerous drugs.

The statutory appropriations c through f are proposed for elimination as part of the proposal to de-earmark the lodging facilities use tax.

- c. Department of Commerce (15-65-121, MCA)
- d. Historical Society (15-65-121, MCA)
- e. University of Montana (15-65-121, MCA)
- f. Department of Fish, Wildlife and Parks (15-65-121, MCA)
- g. Department of Commerce (17-06-409, MCA) - Appropriates revenue from

SB 378 - DEDICATED REVENUE PROVISIONS

interest earned on outstanding loans to the Microbusiness Finance Program of the Department of Commerce.

- h. Board of Public Education (20-04-109, MCA) - This section appropriates \$3 of the \$6 annual teacher certification fee to the Teacher Certification Advisory Council for special teacher development and training projects.
- i. Department of Fish, Wildlife and Parks (23-02-823, MCA) - This section statutorily appropriates federal grants awarded to department for off-highway vehicle safety education programs.
- j. Judiciary (27-12-206, MCA) - Appropriates revenue from licensed chiropractor assessments to fund the Montana Chiropractic Legal Panel.
- k. Department of Justice (61-02-107, MCA) - Appropriates \$50,000 general fund annually to the Forensics Sciences Division to purchase breath analyzing equipment.
- l. Department of State Lands (77-01-808, MCA) - Appropriates revenue received from state lands recreational use licenses, fines, and forfeitures to improve state owned lands.
- m. Department of Agriculture (80-11-310, MCA) - This section appropriates one half of one percent of the price received from the sale of alfalfa seed to the Alfalfa Seed Committee. Funds are used to develop and improve control measures for disease and pests which attack alfalfa seed pollinators.
- n. Department of Health and Environmental Sciences (75-5-507, MCA) - Fines and penalties deposited to the water quality rehabilitation account are statutorily appropriated to mitigate water pollution.

Proposed Clean-up Legislation

During its review and research into the possibilities of de-earmarking state special revenue sources, four sections of statute were identified where non-substantive amendments would clarify existing statute. The committee recommends the following clean-up statutory amendments:

- 1. Clarify existing coal severance tax statute by amending statute to express all allocations as percentages of total collections.
- 2. Clarify existing gasoline dealers' license tax statute by amending statute to express the allocation of tax revenue as percentages of receipts net of refunds, as per a 1980 Attorney General's opinion.
- 3. Clarify existing lodging facilities use tax allocations by amending statute to express allocations of the tax revenue as percentages of the balance after the Department of Revenue administrative expenses and general fund deposits have been taken into consideration.
- 4. Clarify existing statute (and SB 378 intent) by amending statute to allocate 100 percent of interest earnings from coal severance tax funds to the general fund (17-5-704, MCA).

RETIREMENT INCENTIVE PROGRAM

Overview

The 1993 legislature enacted HB 517 which provided a retirement incentive program (RIP) for state employees. Members of both the Public Employees' Retirement System (PERS) and the Teachers' Retirement System (TRS) were eligible for the program.

Eligibility

PERS members were eligible for the RIP if they were age 50, with at least 5 years of service; or had 25 years of service, regardless of age. They were required to terminate employment during the early retirement window which was after June 24, 1993, but before January 1, 1994. The employing agency was required to purchase one year of service for each five years of service for retiring employees, up to a maximum of three years of additional service. The purchase of additional years could be financed over a 10 year period at an interest rate established by the PERS board.

TRS members were eligible for the RIP if they were employed on a full-time basis as of February 1, 1993 and eligible for normal or early retirement. Optional retirement participants were eligible if they were employed on a full-time basis as of February 1, 1993, and at least 50 years of age. Eligible TRS members had to announce on or before December 1, 1993 an intent to terminate employment no later than the end of the 1993-94 academic contract year or the end of the 1994 summer session. Unlike PERS employers, the employing Montana University System (MUS) unit could not finance the early retirement costs. Instead, employing units had to make cash payments equal to one year of the combined member and employer contributions to TRS for each five years of creditable service, not to exceed the amount of combined contributions for three years.

Impact of RIP

HB 517 required that a report on the effect of the RIP be presented to the Fifty-fourth legislature by the Department of Administration in cooperation with PERS and TRS boards. While this report **will** be presented to the legislature during the 1995 session, it

was unavailable for review prior to publication of the LFA 1997 Biennium Budget Analysis.

Although the report is not yet available, LFA staff was able to review the raw data collected by PERS on the RIP. When the final report on the RIP becomes available, LFA staff will perform a detailed analysis of the impact of the program. The following are general observations from the review of the raw data.

- RIP cost information was provided to PERS by all state agencies and MUS units except for Montana State University.
- Most state agencies chose to pay off their early retirement costs in fiscal 1994, as opposed to financing them over a 10 year period.
- Most agencies experienced overall budgetary savings due to the RIP.
- In some agencies, the RIP resulted in increased expenditures. Agencies experiencing increased expenditures were primarily non-general fund agencies (FWP and DoT) that had a large number of technical personnel that retired from positions that needed to be filled immediately due to workload demands.

PERFORMANCE-BASED BUDGETING

Performance-based budgeting is a budgeting method that relates expenditures and revenues to workloads. It reflects a management orientation to efficiency in production. Performance budgets feature each program or sub-program with its own unit cost and goals. Goals and activities are defined to direct the program, and defined measures are used to evaluate efficiency and economy.

During the 1993 regular session, the legislature included language in the general appropriation act encouraging the Governor to foster development of a mission-driven, results-oriented budget system to enhance flexibility and improve decision-making information available to the legislature during the 1995 legislative session. The pilot project involved selected, non-general fund programs. Appropriations are to be related to units of work. The expectation is that budget reductions can be enacted only with corresponding work reductions. The pilot programs would sustain no "across-the-board" cuts.

The pilot agencies chosen by the executive are: 1) the Montana State Library Natural Resource Information System (NRIS) program; 2) the Department of Military Affairs Air National Guard program; and 3) the Department of Administration Mail and Distribution program (see individual program narratives in the "Agency Budget Analysis" section of the LFA 1997 Biennium Budget Analysis). If the legislature approves, these 1997 biennium budgets will be based on unit work costs, and the programs will be evaluated by pre-defined measures in the next budget cycle.

TASK FORCE TO RENEW MONTANA GOVERNMENT

In early 1994, the Governor created a Task Force to Renew Montana Government, funded with private funds. The task force was to conduct a thorough examination of government operations. The final report of the task force was presented to the Governor in October 1994.

The recommendations of the task force call for reorganizations of some state agencies in the education and natural resource functions into larger and fewer agencies. Several other smaller agencies are merged, with emphasis on larger, more centralized agencies throughout the task force recommendations.

The fiscal impact of the proposals is not yet known, although there is no immediate projected savings from the proposals. None of the proposals were addressed in the Executive Budget, although the Governor has indicated that he intends to support some of the task force recommendations.

Several bills will be introduced in the 1995 legislature to implement the task force recommendations, and fiscal notes are being prepared.

HEALTH CARE AUTHORITY

The 1993 legislature passed SB 285 creating the Montana Health Care Authority (authority), and HB 145 authorizing a \$1.35 million general fund biennial appropriation for the authority. The authority is composed of five voting members appointed by the Governor and four ex officio members, including the directors of the departments of Social and Rehabilitation Services and Health and Environmental Sciences, the Attorney General, and the State Auditor. SB 285 directed the authority to "submit a report to the (1995) legislature that contains the authority's recommendation for a statewide universal health care access plan based on a single payer system and a recommendation for a statewide universal access plan based on a regulated multiple payer system" on or before October 1, 1994. In addition to the two required plans, the authority has published a third plan, incremental market reform, for consideration by the legislature.

The authority developed and published both universal access plans by the required date. Consultants to the authority estimated that extending universal health care coverage to all Montanans would cost \$2.59 to \$2.62 billion in 1996, with the single payer plan being the least expensive alternative. Either the single payer or multiple payer systems would initially cost \$17.5 to \$52.6 million more, respectively, than doing nothing to reform the health care system. The initial cost increase results from extending coverage to an estimated 12 to 16 percent of the Montanan population that is without health insurance. However, by the year 2005, either plan would be less expensive than doing nothing to reform the health care system, and adoption of the single payer plan would result in savings of \$266 million, while adoption of the multi-payer plan is estimated to save \$540 million. Projected savings are due, in large part, to the establishment in SB 285 of annual limits on growth in the cost of specified services.

Both insurance plans include a comprehensive preventive care benefits package, with lower co-payments and deductibles than other services. Otherwise the benefits packages are different. The single payer plan includes a much more comprehensive benefit package and lower co-insurance, deductibles, and out-of-pocket maximums than the multi-payer plan. Benefits under the single-payer plan would be offered under a managed care (HMO health

maintenance) type organization or under the traditional fee-for-service. Under the multi-payer plan, employers would be required to offer employees (but not pay for) a basic health benefits package and individuals would be required to purchase health insurance.

The multi-payer plan also includes insurance market reforms so that all Montanans can get and keep health insurance. The reforms are: 1) insurance must be portable and not tied to a job; 2) after a one year waiting period, pre-existing conditions must be covered and insurance cannot be denied due to a pre-existing condition; and 3) no one can be denied or lose insurance due to poor health. Finally, the multi-payer plan includes subsidies for certain low-income individuals.

The authority developed a third plan for consideration by the legislature because: 1) it believed that enactment of either the single- or multi-payer systems by October 1995 as required by SB 285 would be too expensive and "too precipitous" a change in the Montana health care system; and 2) public opinion, as measured in a telephone survey, supported gradual, incremental health care reform. The third plan currently includes the following elements:

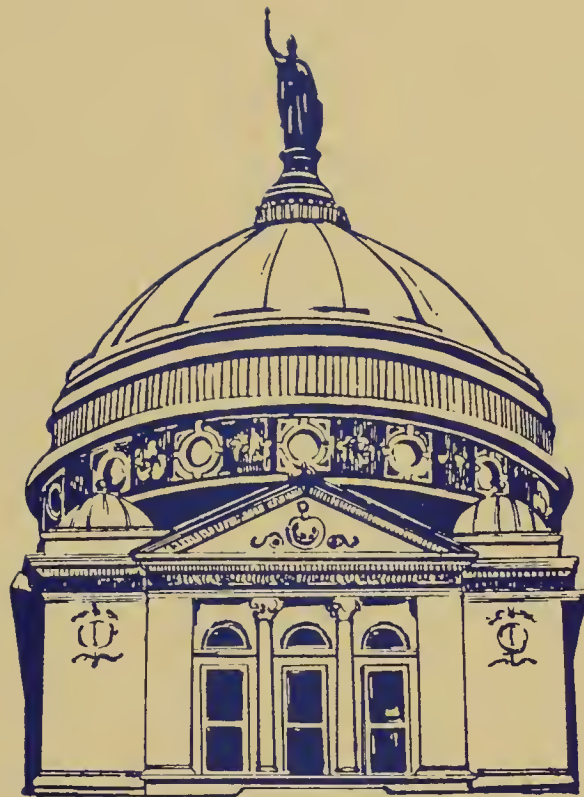
- Expand medicaid coverage for low-income pregnant women and children aged 0 to 6 years old to 200 percent of the federal poverty level and state participation in private sector insurance programs for low-income children age 7 through 18 years old.
- Expand support for the Family Practice Residency Program as a way to increase access to primary care physicians, particularly in rural areas.
- Allow individuals without health insurance coverage through the work place and self-employed individuals a tax deduction for health insurance premiums equal to that given business and allow tax exemptions for those individuals who establish medical savings accounts.

HEALTH CARE AUTHORITY

- Require employers to offer health insurance, but not pay for the insurance, to employees.
- Health insurance market reforms including: 1) no one can be dropped from or denied health insurance coverage due to poor health; 2) health insurance should be portable between jobs; 3) a single 12-month coverage exclusion due to pre-existing conditions should be established; 4) health insurance premium pricing based on age differences only should be gradually phased in; 5) establishment of purchasing pool options including a basic benefits package and a benefit package with an average level of coverage; and 6) apply these market reforms to employers with 1 to 100 employees.

The plan has not yet been finalized. Therefore, costs have not yet been determined. However, preliminary estimates are that expansion of medicaid coverage would cost from \$7 to \$14 million, depending upon the final elements of the plan. Estimated costs of the self-employed individuals tax deduction are not anticipated to exceed \$7 million.

HEALTH CARE AUTHORITY



TAX POLICY AND INITIATIVES

TAX POLICY & INITIATIVES - SUMMARY

Summary

The Executive Budget contains six proposals which affect state revenue during the 1997 biennium. In total, the six proposals reduce revenue by \$20.2 million in fiscal 1996 and increase revenue by \$4.1 million in fiscal 1997, for a net reduction of \$16.1 million during the 1997 biennium.

The fiscal impact of these proposals on the state general fund and the school equalization account (SEA) are shown in Table 1. This section presents a brief summary of these proposals and the following section presents in-depth analyses.

Table 1
Executive Budget
Summary of General Fund/SEA Revenue Proposals
Figures in Millions

	Fiscal 1996	Fiscal 1997	Biennium
Individual Income Tax Refund	(\$25.000)	\$0.000	(\$25.000)
Permanent Coal Tax Trust			
Job Investment Act (Mezzanine Financing)	(0.039)	(0.075)	(0.114)
Microbusiness Financing Act	(0.024)	(0.057)	(0.081)
University System R&D Grants	(0.312)	(0.817)	(1.129)
Oil & Gas Taxation Reform (Project 95)	0.000	5.000	5.000
Coal Severance Tax Reallocation	5.200	0.000	5.200
Total Revenue Proposal	(\$20.175)	\$4.051	(\$16.124)

Individual Income Tax Refund

The largest revenue proposal is an income tax refund of \$25 million dollars which would reduce income tax collections in fiscal 1996. The Executive Budget states that the ending fund balance for fiscal 1995 is expected to exceed the amount budgeted by the legislature during the 1993 regular and special sessions. The executive proposes an income tax refund for any ending fund balance in the general fund which exceeds the \$24.4 million budgeted by the legislature.

Permanent Coal Tax Trust Proposals

Three of the proposals would reduce coal tax trust interest earnings due to reductions in the size of the coal tax trust, or from reductions in interest earnings accruing to the proposed investments of coal tax trust funds. The total estimated loss in interest earnings as a result of these proposals exceeds \$1.3 million during the 1997 biennium.

TAX POLICY & INITIATIVES - SUMMARY

Job Investment Act (Mezzanine Financing)

The mezzanine financing proposal would utilize \$8.0 million in coal tax trust funds for loans to private businesses for working capital and asset acquisition. Interest earnings from this program would be deposited in the general fund and the SEA. The purpose of the proposal would be to create jobs in Montana.

Microbusiness Financing Act

The microbusiness financing act proposal would appropriate \$3.25 million in coal tax trust funds to the Department of Commerce for expansion of the microbusiness finance program. This program authorizes loans to microbusiness development corporations who in turn loan out money to small businesses. Currently, \$3.25 million of coal tax trust funds are loaned through this program. Interest earnings from this program are retained by the Department of Commerce. Authorization of this proposal would require a three-quarters vote of the members of each house of the legislature.

University System Research and Development Grants

The university system research and development (R&D) funding proposal would grant \$13.0 million in coal tax trust funds to the Montana University System (MUS) to finance research and development projects. Matching requirements, although not specific, are part of this proposal. Since this is a grant program, the loss of the coal tax trust funds would be permanent and result in interest losses of over \$1.1 million during the 1997 biennium. Interest losses would continue and increase in future biennia. Authorization of this proposal would also require a three-quarters vote of the members of each house of the legislature.

Oil and Gas Taxation Reform (Project 95)

The oil and gas taxation reform proposal (Project 95) would simplify the taxation of oil and gas by consolidating the many local and state taxes on these resources into a single oil and natural gas production tax. On the whole, the proposal is expected to be revenue neutral for state and local governments, and tax liability neutral for producers of oil and natural gas. In addition, the executive proposes to accelerate collections of the local government severance tax. The executive estimates that the acceleration proposal would result in \$5.0 million in additional state revenue in fiscal 1997.

Coal Severance Tax Reallocation

The coal severance tax reallocation proposal would allocate 12 percent of coal severance tax collections to a long-range building program account. For fiscal 1996 only, the proposal recommends that \$5.2 million not needed for debt service on building projects be transferred to the general fund.

The narrative on the following pages presents an in-depth analyses of the revenue proposals contained in the Executive Budget.

INCOME TAX REFUND

The executive proposes to refund to individual income taxpayers \$25 to \$30 million of excess general fund balance during fiscal 1996 based on executive ending fund balance projections. The total amount issued would depend on the general fund ending balance in excess of \$24.4 million --- the balance anticipated by the Fifty-third Legislature.

As shown in Table 3 of the "State Fiscal Outlook" narrative, the LFA is (using revenue estimates adopted by ROC) projecting the ending fund balance to be \$34.1 million. If the legislature agrees with the policy of refunding any excess balance over \$24.4 million, then total refunds issued would be approximately \$9.7 million. The average refund per taxpayer would be approximately \$20.

PERMANENT COAL TAX TRUST PROPOSALS

The Executive Budget contains three proposals to enhance business performance, job creation and research and development in the state of Montana. Two of these proposals would be funded by loaning a portion of the coal tax trust to businesses. The third proposal would grant coal tax trust monies to the University system. These proposals are:

- Job Investment Act (Mezzanine Financing)
- Expansion of the Microbusiness Financing Act
- University System R & D Grants

Job Investment Act (Mezzanine Financing)

Beginning July 1, 1995, the Job Investment Act would authorize the Department of Commerce to invest up to \$8 million of coal severance tax trust funds in loans to private businesses to finance working capital and fixed asset acquisitions for the purpose of business expansion and job creation. The maximum loan to any one business would be \$500,000 and must be matched by an equal amount in equity or debt acquired funds. As the loans are repaid, the Department of Commerce may reinvest the principal in new loans. Any interest earnings the loans generate must be distributed in the same manner as coal tax trust investments, except that 2 percent of these earnings are to be deposited in a special revenue account for use by the department to administer the program. In addition, this account would receive all loan origination fees and service charges paid by borrowers.

The loans contemplated under this proposal would be highly structured, with payments of principal and interest by the borrowing entity to begin immediately upon approval of the loan. The default rate for the types of loans under this proposal is expected to be far smaller than the default rate for the more risky venture capital

projects funded by Montana Science and Technology Alliance.

The enactment of this act would reduce coal trust interest earnings during the 1997 biennium. The executive estimates that net interest earning losses to the general fund and the SEA would be \$39,000 in fiscal 1996 and \$75,000 in fiscal 1997. This assumes that \$6.6 million of the \$8 million would be loaned out at a rate of \$300,000 per month during the 1997 biennium, beginning in September 1995. It is assumed that these funds would have earned an average return of 8 percent if retained in the coal tax trust. Payback of principal and interest at 10 percent were assumed to take place beginning in November 1995, and the principal returned was assumed to return to the trust.

The total interest foregone on the coal tax trust dollars under these assumptions would be \$110,000 in fiscal 1996 and \$396,000 in fiscal 1997, which would be the net loss in interest to the general fund and SEA if no payback occurs under this program. The likelihood of payback of these loans would depend on how the department structured the terms of the loans and on the degree of scrutiny the department invested in analyzing potential borrowers.

The Job Investment Act proposal would not require approval of three-quarters of the members of each house of the legislature for passage, since the funds loaned out retain their identity as coal trust fund monies.

Expansion of Microbusiness Financing Act

The Executive Budget seeks legislative approval to expand the Microbusiness Financing Act which provides loans to businesses employing less than ten employees and generating less than \$500,000 in gross revenue annually. The expansion of this

PERMANENT COAL TAX TRUST PROPOSALS

program would double the current appropriation of \$3.25 million of investable coal tax trust funds made available to the Microbusiness Finance Program in the Department of Commerce. Current law restricts loan amounts to \$20,000 per individual loan and the proposal would increase this amount to \$35,000. The program provides financing for working capital assets and fixed asset acquisition with more flexible repayment terms than those offered by commercial financial institutions. Payback of interest and principal of the loan amounts is used for administrative costs and for financing new microbusiness loans.

Under the current program all \$3.25 million has been loaned to 7 microbusiness development corporations, who in turn loan out the money to small businesses meeting statutorily defined criteria.

The executive estimates that coal trust interest earnings would decrease by \$24,000 in fiscal 1996 and \$57,000 in fiscal 1997. This estimate was derived by assuming that quarterly draws of \$390,600 would be made and that a total \$3.125 million would be withdrawn during the 1997 biennium. No payback of loaned funds or interest was assumed.

The Microbusiness Financing Act expansion would require a three quarters vote of the members of each house of the legislature, since the money would be appropriated to the Department of Commerce.

University System Research and Development Grants

The Executive Budget proposes to use \$13 million in coal tax trust funds to support research and development activities at Montana's university campuses. A majority of the funds would be used as matching funds for federal and private grants. The balance would fund centers of

excellence and provide a contingency account for project opportunities not yet identified.

The enactment of this program would coincide with the demise of a research and development investment program which is administered by the Montana Board of Science and Technology Alliance (MSTA). MSTTA is authorized to loan up to \$8.1 million for research and development project loans under the provisions of Title 90, chapter 3. This authority will end on June 30, 1995. To date, more than \$7.2 million in loans has been approved, although the actual amount disbursed to date is only \$3.3 million. Payback from this program as of December 8, 1994, is \$411,827. In effect, the proposed program would constitute an expansion of the current MSTTA research and development program, however, the new program would issue grants instead of loaning the funds as under the current program.

The total interest foregone under this proposal is calculated by the executive to be \$265,000 in fiscal 1996 and \$694,000 in fiscal 1997. There would be no payback of any principal or interest, and the loss in interest would be permanent, ongoing and growing.

The university system research and development grant proposal would require a three-quarters vote of the members of each house of the legislature for passage.

OIL AND GAS TAXATION REFORM (PROJECT 95)

Throughout 1994, Department of Revenue staff met with county and school administrators and representatives from oil and natural gas companies to achieve consensus on how the current system of oil and gas taxation should be altered. The goals of the meetings were to simplify the tax system as applied to oil and natural gas while maintaining, as a whole, revenue neutrality for tax collecting governments and tax liability neutrality for tax paying companies. The result of this work is a proposal, endorsed by the executive, called Project 95.

Project 95 proposes a new oil and natural gas production tax which would revamp the taxation of oil and natural gas by: 1) consolidating the number of tax rates applied to oil and gas production; 2) simplifying the tax return process; and 3) accelerating the collection of the Local Government Severance Taxes (LGST) so that the timing between resource production and the collection of the LGST corresponds with other taxes applied to oil and natural gas. The proposal would apply to resource production beginning in calendar 1996.

Consolidated Tax Rates

The current tax system contains four major types of taxes, each having unique rules regarding tax filing dates, tax rates, exemptions, and distribution methods that depend on whether the resource is produced from old wells or new wells. Old oil and gas wells (drilled prior to July 1, 1985) are subject to the state severance tax, LGST, the Resource Indemnity and Groundwater Assessment tax (RIGWA) and the Privilege and License Tax. New oil and gas wells (drilled after July 1, 1985 or wells that have not been in production for at least five years) are subject to the state severance tax, the net proceeds tax, the RIGWA tax and the Privilege and License Tax. Table 1 provides a summary of current law provisions regarding the taxation of oil and gas production.

OIL AND GAS TAXATION REFORM (PROJECT 95)

Table 1
Current Law Oil and Natural Gas Tax Provisions

Tax/Resource/Rate Rates as Percentage	Exemptions	Distribution & Distribution Dates	Tax Payment & Return Deadlines	Treatment of Royalties	Stripper Rates **
Net Proceeds * Oil Primary @ 7.00 Secondary @ 5.00 Tertiary @ 3.30 Horizontal @ 7.00 All Natural Gas @ 12.00	First 12 months of production for oil and gas; first 18 months for horizontal oil wells; tribal royalties; royalties received by governments	Received by county treasurer, distributed on basis of mills in previous budget year; distributed to taxing jurisdictions in November and May	Return and payment due quarterly last day of Oct, Jan, Apr, May	Oil = 7.0 % Gas = 12.0 % Same exemptions as working interest	No special rules for stripper wells
LGST * Oil Primary @ 8.40 Secondary @ 5.00 Tertiary @ 3.30 Horizontal @ 8.40 All Natural Gas @ 15.25	Tribal royalties; royalties received by governments	Received by county treasurer and sent to state; redistributed to taxing jurisdictions on basis of levies in fiscal 1990; distributed in November and May	Return due 60 days after end of calendar quarter; payment due 1 year after return	Oil = 12.5 % Gas = 15.25 %	Oil = 5 % Gas = 10 %
State Severance Oil Primary @ 5.00 Secondary @ 3.00 Tertiary @ 2.00 Horizontal @ 5.00 All Natural Gas @ 2.65	First 30,000 cubic feet per day if gas stripper; tribal royalties; royalties received by governments	Collected by state; deposited in state general fund	Return and payment due 60 days after end of calendar quarter	Same as working interest	Gas = 1.59 % on second 30,000 cubic feet per day
RIGWA Tax @ 0.50	Tribal royalties; royalties received by governments	Collected by state; distributed to RIT except 14.1 percent to groundwater assessment account	Return and payment due on 60th day following end of calendar year	Same as working interest	No special rules for stripper wells
Privilege & License @ 0.20	Tribal royalties; royalties received by governments	Collected by state; deposited in account for use by board of oil and gas conservation	Return and payment due 60 days after end of calendar quarter	Same as working interest	No special rules for stripper wells
* Net proceeds applies to production from wells drilled after June 30, 1985, or from wells not in operation for at least 5 years; LGST applies to wells drilled before July 1, 1985. ** Stripper oil wells are those which produce no more than 10 barrels of oil per day; stripper gas wells are those which produce no more than 60,000 cubic feet of gas per day.					

OIL AND GAS TAXATION REFORM (PROJECT 95)

The proposed legislation consolidates tax rates as shown in Table 2. For oil, the new rates would be applied only to primary and stripper oil production. Tax rates for secondary and tertiary oil production would remain as they are under current law, i.e., as enacted in SB 18 during the November 1993 Special Session. The proposal would consolidate the tax for secondary and tertiary oil production, and for production from horizontal wells. For gas, the new rates would be applied to regular gas production and stripper gas production.

Table 2
Project 95 Proposed Oil and Gas Tax Rates*

Type of Tax	Consolidated Tax Rates Expressed as Percentages	
	Oil	Gas
Working Interest - Pre 7/1/85 Wells	14.10	18.75
Working Interest - Post 7/1/85 Wells	12.70	15.35
Working Interest Stripper	11.00	11.20
Working Interest New Incentive **	5.70	3.35
Royalty Interest - All	16.50	15.00

* Tax Rates for primary production only. Tax Rates for secondary and tertiary production (as placed into law by SB 18 during the November 1993 Special Session) remain in effect.

** These rates apply only during the first 12 months of new production.

Proposed Tax Rates for Working Interest Producers

For working interest producers, the proposed rates on primary oil production (new and old) and regular new gas production are the sum of the four major rates under current law. For instance, the four primary oil rates for old oil under current law sum to 14.10 percent, which is equivalent to the proposed consolidated rate. The current law rates for old primary oil include the LGST at 8.4 percent, the state severance tax at 5.0 percent, the RIGWA tax at 0.5 percent, and the privilege and license tax at 0.2 percent. (The proposed rates are equal to the consolidated rates under current law for old and new primary oil and for regular new gas production.) For old regular gas produced by the working interest producer, the proposed tax rate is 18.75 percent compared with the consolidated rate of 18.60 percent under current law. This change was proposed by natural gas producers and agreed to by the working group. Table 3 shows a comparison between the current law consolidated tax rates and the proposed consolidated tax rates for primary oil production and regular gas production.

OIL AND GAS TAXATION REFORM (PROJECT 95)

Table 3 Consolidated Tax Rates on the Working Interest Producers and the Royalty Interest Owners Current Law and Project 95 Recommendations (Tax Rates Expressed as Percentages)		
Interest/Production Type	Current Law	Project 95 Recommendations
Working Interest Producers		
<u>Primary Oil Production</u>		
Old Oil Production	14.10	14.10
New Oil Production		
First 12 Months	5.70	5.70
After 12 Months	12.70	12.70
<u>Stripper Oil Production</u>		
Old Stripper Oil	10.70	11.00
New Stripper Oil		
First 12 Months	5.70	5.70
After 12 Months	12.70	11.00
<u>Regular Gas Production</u>		
Old Gas Production	18.60	18.75
New Gas Production		
First 12 Months	3.35	3.35
After 12 Months	15.35	15.35
<u>Stripper Gas Production</u>		
Old Stripper Gas *		
State Severance Taxable	12.29	11.20
State Severance Exempt	10.70	11.20
New Stripper Gas *		
State Severance Taxable, First 12 months	2.29	3.35
State Severance Exempt, First 12 months	0.70	3.35
State Severance Taxable, After 12 months	14.29	11.20
State Severance Exempt, After 12 months	12.70	11.20
Number of Different Oil Working Interest Production Rates	4	4
Number of Different Gas Working Interest Production Rates	9	4
Royalty Interest Owners**		
<u>Primary Oil Production</u>		
Old Oil Production	18.20	16.50
New Oil Production		
First 12 Months	5.70	16.50
After 12 Months	12.70	16.50
<u>Stripper Oil Production</u>		
Old Stripper Oil	18.20	16.50
New Stripper Oil		
First 12 Months	5.70	16.50
After 12 Months	12.70	16.50
<u>Regular Gas Production</u>		
Old Gas Production	18.60	15.00
New Gas Production		
First 12 Months	3.35	15.00
After 12 Months	15.35	15.00
<u>Stripper Gas Production</u>		
Old Stripper Gas *		
State Severance Taxable	17.54	15.00
State Severance Exempt	15.95	15.00
New Stripper Gas *		
State Severance Taxable, First 12 months	2.29	15.00
State Severance Exempt, First 12 months	0.70	15.00
State Severance Taxable, After 12 months	14.29	15.00
State Severance Exempt, After 12 months	12.70	15.00
Number of Different Royalty Rates for Oil	3	1
Number of Different Royalty Rates for Gas	9	1
* The exemption of the first 30,000 cubic feet of production per day from the state severance tax for gas stripper wells would be abolished under the proposal. ** Royalty interest owners would lose their 12 month new well tax exemption from the net proceeds tax for both oil and gas wells.		

OIL AND GAS TAXATION REFORM (PROJECT 95)

Under this proposal, the working interest producers would retain the 12-month exemption for all new primary oil and new regular gas production. However, the working interest producers would lose the current exemption from the state severance tax for the first 30,000 cubic feet of production per day from gas stripper wells.

The Project 95 proposal also changes tax rates and the number of tax rates for stripper oil and gas produced by the working interest. These changes are shown in Table 3.

Under current law, stripper oil produced by the working interest producer is subject to three different consolidated tax rates:

- 1) for old stripper oil, the consolidated current law rate is 10.7 percent, because of the special old stripper tax rate under the LGST;
- 2) for new stripper oil in the first twelve months of production, the consolidated current law rate is 5.7 percent, because new stripper oil is exempt from the net proceeds tax for the first twelve months of production and because new stripper oil is not subject to reduced stripper rates; and
- 3) for new oil after the first twelve months of production, the consolidated current law rate is 12.7 percent, since new oil is no longer exempt from the net proceeds tax and not subject to reduced stripper rates.

Under the Project 95 proposal, both old stripper oil and new stripper oil produced by working interest producers would be taxed at 11.0 percent. Working interest producers of new stripper oil would retain the 12-month holiday. This would result in an increase in tax liability for producers of old stripper oil, a reduction in tax liability for producers of new stripper oil for production which occurs after the first twelve months, and no

change in tax liability for producers of exempt new stripper oil.

Under current law, stripper gas produced by the working interest producer is subject to six different consolidated rates. Under current law, the first 30,000 cubic feet per day of production is exempt from the state severance tax for both old gas and new gas, and the second 30,000 cubic feet per day of production for a gas stripper well has a reduced gas state severance stripper rate of 1.59 percent. In addition, new stripper gas is exempt for the first twelve months of production from the net proceeds tax. The combination of these exemptions and special rates in current law result in six different consolidated rates applied to stripper gas. These are:

- 1) for old stripper gas which is state severance exempt, the rate is 10.7 percent; and
- 2) for old stripper gas which is state severance taxable, the rate is 12.29 percent;

The proposed rate for all old stripper gas is 11.2 percent, and the combined rate would be applied to all stripper production, including the first 30,000 cubic feet of production now exempt under the state severance tax.

- 3) for new stripper gas in the first twelve months of production, the current consolidated rate is 0.7 percent for the first 30,000 cubic feet per day since this production is not subject to either the state severance tax or to the net proceeds tax;
- 4) for new stripper gas in the first twelve months of production, the current consolidated rate is 2.29 percent for the production which is state severance taxable;

For both of these production classes, the proposed rate is 3.35 percent, and working interest

OIL AND GAS TAXATION REFORM (PROJECT 95)

producers of this gas would realize increased liability under the proposal.

5) for new stripper gas after the first 12 months of production, the current consolidated rate is 12.7 percent for the first 30,000 cubic feet per day since this production is not subject to the state severance tax but is subject to the net proceeds tax; and

6) for new stripper gas after the first 12 months of production, the current consolidated rate is 14.29 percent for production that is state severance taxable.

For both of these production classes, the proposed rate is 11.2 percent, and working interest producers of this gas would realize decreased liability under the proposal.

Under current law, working interest producers have to apply 9 gas tax rates to production in order to determine liability. Under Project 95, only 4 gas tax rates would be applied. The number of rates to which oil working interest producers are subject would remain constant.

Proposed Tax Rate Changes for Royalty Interest Owners

The proposed rates for royalty interest owners of oil and gas wells are also different than current law rates for both primary production and stripper production. These differences are shown in Table 3. Under current law, there are a variety of rates for royalty interest owners of primary oil wells and regular gas wells which depend on whether the resource is produced from old or new wells. Under current law, royalty interest owners are able to take advantage of the 12-month exemption for new oil or gas. In addition, royalty interest owners of gas wells are able to take advantage of the reduced state

severance tax rate applied to gas production from stripper wells.

Under the Project 95 proposal, the 12-month exemption for royalty interest owners of new oil or gas wells would be abolished. In addition, the distinction between old production and new production would be abolished as would the distinction between stripper and non-stripper production. As a result, the number of tax rates which apply to royalty interest owners would drop from 3 to 1 for oil wells, and from 9 to 1 for gas wells. The primary reason that royalty interest owners agreed to the proposed changes was to achieve a more simplified taxing structure than exists under current law.

SB 18 Incentives

The Project 95 proposal does not affect overall tax liability for working interest producers or the royalty interest owners for production from horizontal oil wells, incremental oil production from secondary wells, tertiary wells, or horizontally recompleted wells. These rates were enacted in SB 18 during the November 1993 Special Session. The Project 95 proposal consolidates the tax rates applicable to these wells so that the new consolidated rate equals the sum of the separate tax rates under current law. These consolidated rates are shown in Table 4.

OIL AND GAS TAXATION REFORM (PROJECT 95)

Table 4
Consolidated Current Law Tax Rates for Horizontal
Oil Wells And for Incremental Production from Secondary,
Tertiary And Horizontal Recompleted Oil Wells

Oil Well Type	Tax Rates Expressed as Percentages	
	Working Interest Producers	Royalty Interest Owners
<u>Horizontally Completed Well</u>		
First 18 Months	5.70	5.70
After 18 Months	12.70	12.70
<u>New or Expanded Secondary Wells</u>		
Old Wells	8.70	16.20
New Wells	8.70	10.70
<u>New or Expanded Tertiary Wells</u>		
Old Wells	6.00	15.20
New Wells	6.00	9.70
<u>Recompleted Horizontal Wells</u>		
First 18 Months	5.70	5.70
After 18 Months	12.70	12.70

One Tax Return

As a result of consolidating all oil and gas taxes into a single tax, Project 95 proposes to consolidate a number of tax forms currently filed by oil and gas interests into one quarterly form for all state and local taxes. The return and payment would be due 60 days after the end of the quarter of production.

Accelerated LGST Payment

Under current law, payment of LGST taxes is due quarterly 14 months after the quarter in which the resource is produced, whereas payment of the state severance tax, the net proceeds tax, and the privilege and license tax are due quarterly two months after the quarter in which the resource is produced. Requiring that one return be filed and that taxes be paid 60 days after the quarter in which production takes place results in two years of LGST being collected in

OIL AND GAS TAXATION REFORM (PROJECT 95)

one year. In order to mitigate the harm this might cause producers, the accelerated portion of the LGST for production occurring in calendar 1995 may be paid as follows: the accelerated tax is due in 4 equal payments at 12-, 24-, 36- and 48-month intervals from the date on which the first quarterly payment is due under current law. If the total payment is made within the first six months, the taxpayer would receive a 6 percent discount. If the total payment is made within a 6 to 18-month period, no interest would be due. Any tax paid after 18 months would incur interest at a statutory rate of 12 percent annually.

Project 95 proposes distributing the accelerated LGST collections to counties in the same manner in which the LGST is distributed under current law, i.e. on the basis of LGST unit value. The distribution of the accelerated collections within the county would also be as under current law, i.e. between county governments and schools on the basis of the number of mills levied in fiscal 1990. Under the proposal, counties would be able to place these receipts in a special fund which could be used outside the normal budgeting process and outside of I-105 strictures. Schools would be able to deposit accelerated collections of LGST in any budgeted fund or into an excess reserve fund. If schools deposit the accelerated tax revenue in their general fund, they would be able to designate it as excess reserve revenue and would not be required to reduce general fund mill levies, or offset guaranteed tax base receipts from the state.

In addition to the acceleration of LGST collections, the Project 95 proposal would result in accelerated collections of the RIGWA tax. Under current law, the RIGWA tax is collected 60 days after the end of the calendar year in which production takes place. Quarterly collections of the proposed oil and natural gas production tax would result in accelerated collections of the RIGWA share of this tax. Because all such

collections would take place in a single fiscal year, no additional fiscal year collections would result. Because the state would receive the RIGWA share earlier in the fiscal year than under current law, however, there would be additional interest earnings to state accounts which receive RIGWA collections.

OIL AND GAS TAXATION REFORM (PROJECT 95)

Distribution of the Oil and Natural Gas Production Tax

Under the Project 95 proposal, the state would collect the oil and natural gas production tax. Except for the working interest producers' share of the tax on the first 12 months of production from a new oil well, 41.6 percent of all tax collections would be allocated to the state. The remaining 58.4 percent of the oil production tax would be statutorily appropriated to the county for allocation within the county. As under current law, the working interest producers' share of production taxes on the first 12 months of production from a new well would be allocated 100 percent to the state, to reflect the 12-month exemption under the current net proceeds tax.

Except for the working interest producers' share of the tax on the first 12 months of production from a new gas well, 14.6 percent of all tax collections would be allocated to the state. The remaining 85.4 percent of the gas production tax would be statutorily appropriated to the county for allocation within the county. As under current law, the working interest producers' share of production taxes on the first 12 months of production from a new well would be allocated 100 percent to the state, to reflect the 12-month exemption under the current net proceeds tax.

The share of the oil and natural gas production tax received by the state would be distributed as follows:

- 85 percent to the state general fund;
- 4.3 percent to the Board of Oil and Gas Conservation; and
- 10.7 percent distributed as the RIGWA tax is distributed under current law.

As under current law, the share of the oil and natural gas production tax received by the county would be distributed between school and county

taxing units in a manner different for old production than for new production. The county share of the production tax from old wells would be distributed on the same basis as under the current LGST, where all LGST collections would be pooled at the state level. Each tax levy district, which is made up of several taxing jurisdictions including the state, county, and school districts, is allocated a share of total LGST collections based on an historical unit value for that levy district. The unit value for each levy district is the ratio of old oil and gas tax revenues received in fiscal 1990 to old oil and gas production in calendar year 1988. The share that each levy district receives is then divided among its constituent taxing units based on the mills each taxing unit levied in fiscal 1990.

The county share of tax receipts under the proposed oil and gas production tax, which is derived from new production, would be distributed as the current net proceeds tax is distributed under current law. Under current law, the net proceeds tax is collected by the county and distributed to each taxing unit on the basis of mills levied in the previous year.

Fiscal Impacts

Industry Impacts

To date, the final impacts of the new oil and gas production tax on the tax liability for working interest producers and royalty interest owners in fiscal 1997 has not been calculated. Based on 1993 production data, the changes in effective tax rates appear to be small and changes in tax liabilities also appear to be minimal. As shown in Table 5, some working interests would experience an increase in tax liability, for example, old gas producers would be impacted by the rate increase. Other working interest producers would experience no change in tax liability, such as old primary oil and all new primary oil producers, and all new regular gas

OIL AND GAS TAXATION REFORM (PROJECT 95)

producers. On average, both stripper oil producers and stripper gas producers would realize a small reduction in tax liability. Some producers of stripper oil and gas, however, would experience increases in tax liability while others would experience declines in liability.

Table 5 Effective Tax Rates, by Type of Production For Oil and Gas, Based on 1993 Calendar Year Production (in Percent)			
Interest/Type of Production	Current Law Effective* Rate	Proposed Law Effective* Rate	Percent Change
Oil Production			
Working Interest Old Oil	14.10	14.10	0.00
Working Interest New Oil	11.57	11.57	0.00
Working Interest Stripper Oil	10.88	10.82	(0.55)
Royalty Interests - All Oil	16.94	16.50	(2.60)
Gas Production			
Working Interest Old Gas	18.60	18.75	0.81
Working Interest New Gas	12.70	12.70	0.00
Working Interest Stripper Gas	10.63	10.46	(1.60)
Royalty Interests - All Gas	14.85	15.00	1.01

* Effective tax rate is total tax paid in fiscal 1994 divided by gross value of production in calendar 1993.

Government Impacts

The impact of the new oil and gas production tax on government receipts should, as a whole, also be minimal. Some counties and school districts would experience increases in tax revenue; however, while others would experience decreases. The specific increases and decreases in tax revenue for each taxing jurisdiction have not yet been calculated. In general, those taxing jurisdictions with high concentrations of new stripper oil production, and old and new stripper gas production, would experience declining revenues, while those jurisdictions with high concentrations of new regular gas and new primary oil, would experience increasing revenues.

In addition to the direct gain or loss in tax revenues experienced by school districts as a result of the new oil and gas production tax, there would be secondary impacts on school

revenues because changes in receipts of oil and gas "non-levy" revenues alter the guaranteed tax base (GTB) revenues received from the state. These GTB effects should be small for the state and school districts as a whole, however, the GTB effects for individual districts could be significant.

LGST Acceleration Impact

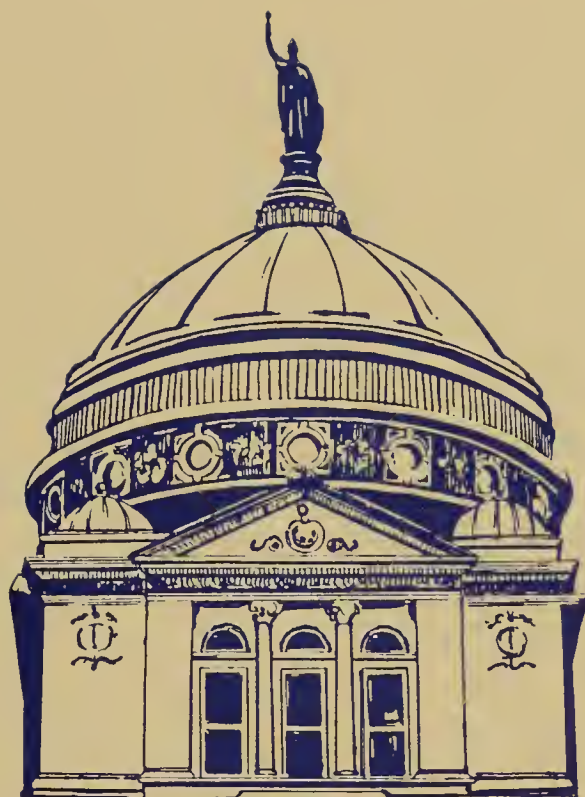
The impact on governmental units resulting from the acceleration of LGST payments would depend on how soon companies paid the accelerated liability. The Executive Budget estimates that all companies would pay within the first six months and receive the 6.0 percent discount. The executive's estimated impact is \$5.0 million to be received by the state in fiscal 1997, however, this estimate appears to be highly optimistic for two reasons. First, it is not likely that all companies would pay early, especially because of high and rising interest rates. Second, the estimate in the Executive Budget was based on calendar 1993 production. Production subject to the LGST is declining, however, as old wells are taken out of production. Moreover, production from these wells in calendar 1995 would be substantially less than it was in calendar 1993 and, as a result, total LGST collections available for acceleration would also be less.

COAL SEVERANCE TAX REALLOCATION

Under current law, 12 percent of coal severance tax revenue is allocated to the highway reconstruction trust fund through fiscal 2003. This allocation currently amounts to approximately \$5.4 million annually. The Executive Budget includes a proposal to reallocate this coal tax revenue from the highway fund to the long-range building program (LRBP) account in the capital projects fund type.

Under the executive's proposal, the coal tax money would either be used for debt service payments on LRBP projects or to fund capital projects. Specifically, the Executive Budget includes a \$193.1 million long-range building program, requiring \$71.7 million in new general obligation debt. The 12 percent coal severance tax collections are targeted by the executive for servicing this debt. For fiscal 1996, however, the executive proposes transferring \$5.2 million of the coal severance tax revenue from the LRBP account to the general fund.

This loss of income to the highway reconstruction trust fund is expected to be offset by increased gasoline and diesel tax collections. The 1993 legislature increased the gas tax by 4 cents beginning in fiscal 1993 and an additional 3 cents in fiscal 1994. In addition, HB 539, passed during the 1993 regular session, changed the timing and point of collection for diesel taxes, resulting in enhanced compliance. (Gas and diesel taxes are discussed in more detail under the Department of Transportation narrative in sub-section A, Volume I of the LFA 1997 Biennium Budget Analysis.)



INDEX

INDEX

Administration, Department of	A-137
Agency Budget Comparisons By Fund	Reference 12
Agency Budget Analysis	Agency-1
Agricultural Experiment Station	E-87
Agriculture, Department of	C-119
Board of Public Education	E-16
Board of Crime Control	D-22
Budget Basics	Reference 1
Bureau of Mines	E-99
Coal Severance Tax Reallocation	Tax Policy 16
Colleges of Technology	E-73
Commerce, Department of	C-136
Commissioner of Higher Education	E-48
Commissioner of Political Practices	A-51
Consumer Counsel	A-21
Cooperative Extension Service	E-94
Corrections and Human Services, Department of	D-115
Cultural and Aesthetic Grant Program	F-21
Crime Control Division	D-22
Economic Overview	Revenue 2
Education	Section E
Environmental Quality Council	A-17
Executive Budget Analysis - Summary	Overview 17
Executive Pay Plan	Overview 43
Expenditure Limitation	Reference 19
Expenditure Proposals	Overview 25
Family Services, Department of	B-105
Federal/State - Mandate Statute	Reference 24
Fire Services Training School	E-103
Fiscal 1995 Supplementals	Overview 41
Fish, Wildlife and Parks, Department of	C-4
Forestry and Conservation Experiment Station	E-97
Fund Balance	Overview 39
General Fund Revenue Estimates	Revenue 16
General Government and Transportation	Section A
Governor's Office	A-23
Guaranteed Annual Benefit Adjustment Proposal	Overview 63
Health Care Authority	Overview 74
Health and Environmental Sciences, Department of	B-144

Highway Traffic Safety	D-27
Historical Society	D-98
Human Services	Section B
Income Tax Refund	Tax Policy 3
Inflation/Deflation	Reference 8
Inflation/Deflation Factor Issues	Overview 65
Institutions and Public Safety	Section D
Introduction	Overview 1
Judiciary	D-1
Justice, Department of	D-31
Labor and Industry, Department of	B-1
Legislative Agencies	A-1
Legislative Auditor	A-3
Legislative Council	A-9
Legislative Fiscal Analyst	A-7
Library Commission	D-86
Livestock, Department of	C-75
Long-Range Planning	Section F
Long-Range Building Program	F-1
Major Economic Assumptions	Revenue 13
Military Affairs, Department of	D-157
Montana Arts Council	D-81
Montana Historical Society	D-98
Montana University System (MUS)	E-36
Agriculture Experiment Station	E-87
Bureau of Mines	E-99
Commissioner of Higher Education	E-48
Cooperative Extension Service	E-94
Fire Services Training School	E-103
Forestry and Conservation Experiment Station	E-97
Six University Units	E-80
Colleges of Technology	E-73
Natural Resources and Commerce	Section C
Natural Resources and Conservation, Department of	C-94
Office of Public Instruction	E-1
Oil & Gas Taxation Reform (Project 95)	Tax Policy 6
Oil Overcharge Funds	F-13
Performance-Based Budgeting	Overview 72
Permanent Coal Tax Trust Proposals	Tax Policy 4
Public Employees' Retirement Board	A-185
Public Service Regulation	C-1
Resource Indemnity Trust Interest Accounts	F-15
Retirement Incentive Program	Overview 71
Revenue, Department of	A-109

Revenue Proposals	Overview 24
Revenue - Resource Indemnity Trust Interest Accounts	Revenue 76
Revenue Section Introduction	Revenue 1
SB 378 - Dedicated Revenue Provisions	Overview 67
SEA Revenue Estimates	Revenue 53
School Equalization Account	Overview 51
School for the Deaf and Blind	E-21
Secretary of State	A-44
Social and Rehabilitation Services, Department of	B-26
State Fiscal Outlook	Overview 5
State Auditor's Office	A-55
State Lands, Department of	C-49
State Library Commission	D-86
State Compensation Mutual Insurance Fund	A-184
Statutory Appropriations	Reference 22
Structural Imbalance	Overview 61
Task Force to Renew Montana Government	Overview 73
Tax Policy & Initiatives - Summary	Tax Policy 1
Teachers' Retirement Board	A-189
Transportation, Department of	A-69
Treasure State Endowment Program	F-10
Trust Funds - Balances & Interest Earnings	Revenue 71
Universities	E-80
Vocational Education Council	E-34

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